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Tax Reform Throughout U.S. History and The Economic Impact

by

Jacob Michel

A Thesis Submitted in Partial Fulfillment
Of the Requirements for the
University Honors Program

Department of Accounting
The University of South Dakota
May 2021

The members of the Committee appointed to examine
the thesis of Jacob Michel find it
satisfactory and recommend that it be accepted.

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ABSTRACT

Tax Reform Throughout U.S. History and The Economic Impact

Jacob Michel

Director: Dr. Kathryn Birkeland

The three largest tax reforms in recent years, The 1986 Tax Reform Act (TRA of 1986), The Bush Tax Cuts Act, and The Tax Cuts and Jobs Act (TCJA), differed in the treatment of taxable income through capital gains tax rate, depreciation treatment, limitation of losses, standard deduction, and the marginal rates in general. These provisions were studied to provide insight into how they affected various stakeholders. The TRA of 1986 and the Bush Tax Cuts Act have data determining whether they benefitted high-income taxpayers to the highest extent. The low-income taxpayers were also given tax breaks, however, not to the extent of high-income earners. The TCJA was passed in 2017 and does not have enough evidence on the long-term impact, but there were short-term effects and preliminary impacts to these stakeholders. Lastly, the economy, in the aggregate, was targeted for each tax reform to determine the effectiveness of the provisions on growing the economy. Both the TRA of 1986 and The Bush Tax Cuts Act proved to be successful in the short term at growing the Gross Domestic Product (GDP), but there were recessions not long after each one was passed.

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Tax Reform Throughout U.S. History and The Economic Impact

1. *Introduction*

One of the most controversial topics in society has been governmental taxes on income. It is near impossible to make an income tax system that is both fair to all parties and beneficial to the greater good of the economy. Taxation is a complex topic, but its importance to the growth of the economy cannot be overlooked.

Government revenue from income taxation can be accumulated through individuals and businesses involving various tax return forms that tax accountants service each year. These forms include tax from capital gains, dividends, interest and wages. While businesses and individuals are both forced to pay taxes, individuals account for more than five times the tax revenue that businesses provide. By looking at past and present tax code changes, there is data to explain the methods of taxation which provide the greatest benefit to the largest number of people. Recently, President Trump signed the TCJA of 2017 which contained the largest number of changes since the TRA of 1986. This paper will also discuss the tax changes implemented in 2001 and 2003 characterized as the Bush Tax Cuts Act. These changes will be discussed on how they affected each income group, how they affected businesses between regular C Corporations and pass-through S Corporations, and how they affected the economy. The measures used to track the economic impact are the unemployment rates, federal tax receipts, a look at the theory of the supply of labor, and GDP growth. The last thing this paper will investigate involves recommendations for the next tax reform after determining the results of this study.

2. The 1986 Tax Reform Act

The TRA of 1986 is the largest tax reform since the passing of the newest tax code, the TCJA of 2017. In general, the TRA of 1986 lowered tax rates for many individual filers and implemented a lower flat tax rate for corporations. One of the pressures to pass this legislation was from concern that large corporations and high-income individuals were not paying their fair share of taxes (Nellen and Porter, 2016). The public's perspective on the fairness of a tax system cannot be overlooked as the proper treatment of taxing income can motivate an increase in work. The TRA of 1986 was implemented under the Reagan administration, and it was estimated to cost the government $122 billion in lower federal tax receipts between the years 1987-1991. The tax reform lowered the overall tax liability for the economy. Even though the overall taxes paid were lessened by pure numbers and percentages, with the other changes enacted and looking at where the majority of American household income's lie, 40% of households had an equal or even higher tax liability under the reform.

Table 1

Marginal tax rate (percent)

Filing status	Gross income (1985)	1980	1985	1988
Single	$7,500	18	14	15
Single	$14,000	21	18	15
Married filing jointly	$25,000	21	18	15
Married filing jointly	$40,000	32	28	28
Married filing jointly	$100,000	54	45	33
Married filing jointly	$200,000	64	50	28

Source: www.taxfoundation.org, Historical Tables

Low income

The first change within the TRA of 1986 that was important to low income earners was the tax rate on the lowest income bracket was increased from the previous year's percent. As shown in Table 1, in 1985 the lowest income tax bracket's marginal tax rate was 14%, whereas, in 1988, it went up to 15% (Congressional Research Service [CRS], 1985). Even though this is a small change, this income bracket was the only tax bracket to increase its percentage under the reform.

The change in the tax reform that benefitted low earners the most was the increase in the standard deduction. Even though the standard deduction can be taken by any taxpayer who doesn't itemize, low-income households saw the largest benefits from this expansion. The standard deduction is supposed to portray a line of what is considered the poverty line. This is so households do not have a tax liability if they are struggling financially. Before the tax reform, the single filing standard deduction was $2,540 and $3,670 for married filing jointly taxpayers (Atkins, 2005). In 1988, these amounts were raised to $3,000 and $5,000 for single and married taxpayers, respectively (CRS,1985). There was also an additional deduction able to be taken from those who are at least 65 years of age and/or are blind. Following this, there was an estimated six million working taxpayers who did not have to file a tax return at all, because of the increase in the standard deduction (Poterba, 1987).

Low-income households also recognized benefits from the TRA of 1986's increases in deductions and credits and new ones that were offered. The TRA of 1986 increased the amount of the earned income credit (CRS,1985). This credit was directly calculated by the income and the number of dependents the filer can claim for the tax

year. President Reagan said this credit is “the best anti-poverty, the best pro-family, the best job creation measure to come out of Congress” (Furman, 2014). The earned income credit could be taken by low-income to moderate-income families, increased by each additional dependent and phased out as the filer had a higher income. Back in 1986, if one earned $11,000 or more, this credit could not be taken. If one earned under $11,000 income, one could get as high as a $550 credit at an income level between $5,000-$6,500, and the credit again decreased as the income increased until the $11,000 phase-out was in place. Even though this may not seem like a large number, $550 is worth about $1,300 in 2020 dollars, and $550 was a large percentage of the income of someone who made less than $6,500 per year. In the same light, the tax reform also raised the personal exemption amount to $1,900 in 1987, which is an exemption the taxpayer can take no matter what (CRS, 1985). This exemption could be taken by all taxpayers who filed a tax return; however, this increase affected the low-income filers to the highest degree.

Middle income

There are other provisions related to deduction amounts that affected taxpayers differently depending on the taxable income amount and other circumstances. These deductions pertained mostly to itemized deductions on the Schedule A form of the tax return and impacted the more affluent earners. The only way to take these deductions was to have an aggregate income higher than the standard deduction. The miscellaneous itemized deductions were limited to a floor of at least 2% of adjusted gross income (AGI) to be taken. There was no deduction allowed if the amount was below 2% of the adjusted gross income of the taxpayer. Medical expenses that could be deducted went up to 7.5% of AGI instead of 5% previously. State and local sales taxes were no longer able to be

deducted (CRS, 1985). This deduction was, and still is, for taxpayers who paid certain taxes towards state and local governments throughout the year. These taxes follow a rule where a taxpayer can either choose to deduct state sales taxes or the amount of state and local income taxes paid from the prior year. Even though these deductions became more limited, the change was not massive in terms of lowering the tax liability compared to the decrease in tax rates.

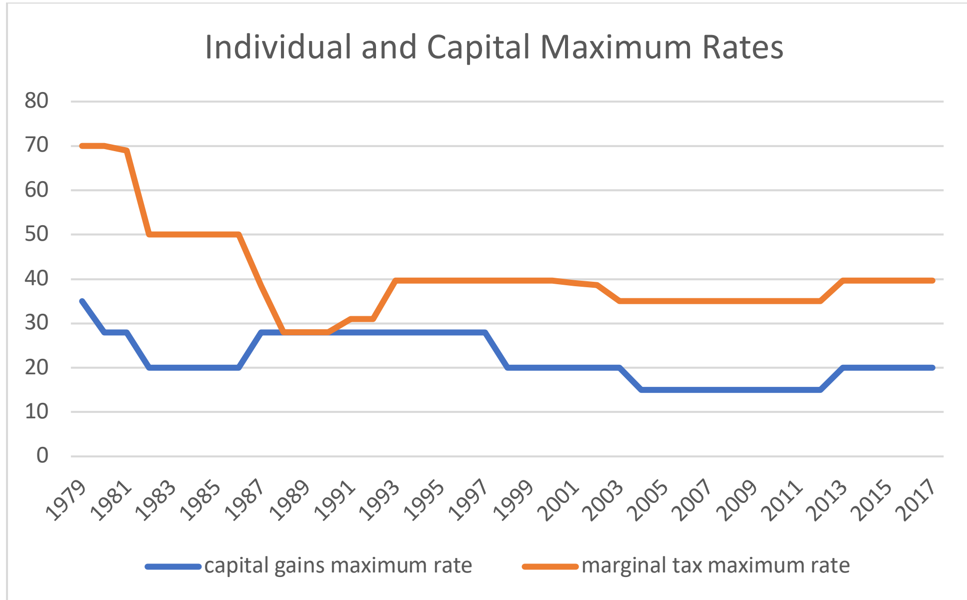
While low-income and high-income households both benefitted under the TRA of 1986, middle-income households saw the least amount of savings. In essence, this group was practically the same. From Table 1, the highest marginal tax rate was from $43,151 to $100,480 at 33%. In 1986, the median household income was $23,620 in 1985 (Census, 1987), which was taxed marginally at 28%, the same as the high-income earners.

High income

Under the 1986 taxation system, the high-income households saw the largest tax savings. This bracket's marginal tax rate saw the largest decrease. The high-income tax bracket was taxed at 28%, which was lower than those who generated $43,151-$100,480 in taxable income. The last time the maximum individual tax rate was this low was in the period 1925-1932 (Graetz, 2011). Perhaps these low rates came about because Reagan himself did not believe a progressive tax was morally correct, as it went against biblical tithe saying that a tax of "10% from the rich and poor alike" (Graetz, 2011). Even if so, Reagan regarded the tax reform as "the best anti-poverty measure, the best pro-family measure and the best job-creation measure ever to come out of the Congress of the United States" (Graetz, 2011).

Another way high-income earners were targeted under the TRA of 1986 was the differential treatment in long-term capital gains. Under the reform, the capital gains rate rose to 28%, the same as ordinary income for the top marginal rate (CRS, 1985). This raised a whole new discussion on the proper way to tax capital to incentivize investment and entrepreneurship while deciphering it from tax shelters and other tax planning strategies to avoid income tax. There are opposing perspectives about what rate to use on long-term capital gains. One of the views is that a lower rate for capital gains will prove to be productive since more earnings will be invested. On the contrary, some say a lower gains tax rate provides a way for income to be sheltered through investment without considering the funds invested. Additionally, when the capital gains tax rate equals ordinary income, incentives change. Investing becomes less attractive, since earnings from wages has the same tax rate. As can be seen from Figure 1, which is data from the Tax Policy Center, the maximum capital gains tax rate has been lower than the maximum individual income tax rate in all periods except the period when the TRA of 1986 was implemented.

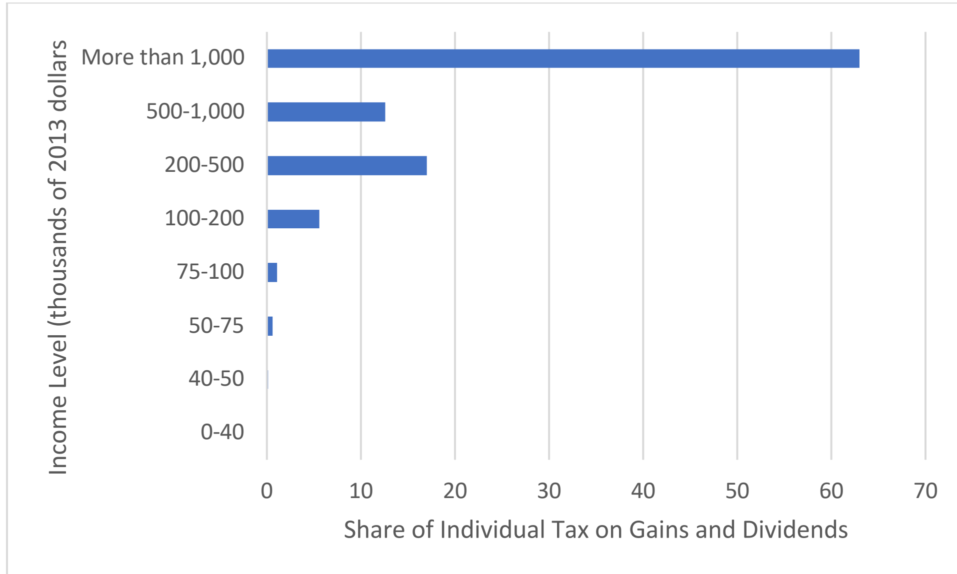
Figure 1



Source: www.taxpolicycenter.org, Briefing Book

High-income households were most affected by the capital gains rate change as they had, and currently have, the most earnings being taxed in this way. According to the Tax Policy Center, the richest 1 in 100 households realized almost 70% of capital gains, and the richest 1 in 1,000 households realized about 47% of capital gains. As can be seen from Figure 2, of the share of positive individual income tax on gains and dividends, 92.6% of this statistic is from the top three income levels in 2013. Given this, the high-income earners were negatively affected by the change to the largest degree between all income groups.

Figure 2



Source: www.taxpolicycenter.com, Statistics Guide

Corporations

The TRA of 1986 was passed to shift tax responsibility from individuals to corporations. While individuals were given tax breaks and tax cuts, corporations saw tax changes in an attempt to raise their tax liability. According to The National Bureau of Economic Research, this did not happen as the Internal Revenue Service (IRS) had hoped. Even though the corporate tax rate decreased, other changes were supposed to make up for the lost revenue and then some. These were the elimination of the investment tax credit, lengthening of depreciation life schedules, and limitations on certain deductible items (Poterba, 1992). From these changes, it is first important to look at the implementation of the new decrease in corporate tax rates. The new tax structure and percentages were phased in instead of changing everything at once within the same year. The phase-in timing was as follows: the first phase started January 1st, 1987, when the

marginal rate of the top bracket went from 46% to 40% for December year-end firms. Then for June-fiscal-end firms, from January 1st through June 30th, 1987, the marginal rates stayed the same. On June 1st of 1987, it moved directly from 46% to 34% (Scholes, Wilson and Wolfson, 1992). This lower tax rate lifts a burden on corporations' liabilities at the end of the tax or fiscal year, resulting in savings that could be used to reinvest in the firm or to distribute a larger dividend. Either way, it can be beneficial for long-term growth in the corporation as investing in more capital or research and development funds allows the corporation to produce more goods, take care of more people in their services, and have the capabilities to improve serving their consumer base. Of course, these results happen only if the overall tax liability were to decrease; however, some limitations prevented this.

The provisions within the TRA of 1986 that countered the lower tax rates were the more stringent rules that extended the depreciation life of many business assets placed in service after December 31, 1986. Instead of assets with a life of three years, five years, and ten years, the reform implemented a seven-year, a twenty-year, a twenty-seven and a half years, and a thirty-one and a half year for the life of certain business assets (CRS,1985). This change decreased the short-term allowable deduction, which in turn increased the taxable income. However, the extension of asset life allowed assets to create deductions for a longer period than they would have in the past. Overall, the amount deducted was the same, this provision just changed the timing of the deduction from assets' depreciation. The reform also eliminated the investment tax credit for property placed in service after December 31, 1985 (CRS, 1985). This credit was launched in 1962 to incentivize business investment by allowing businesses to deduct a

certain percentage of their investments. Lastly, a smaller change was the new limitations on specific business deductions because the TCJA implemented the same changes. These limitations offset the lower marginal rates, so the AGI or the taxable income was higher for most corporations. These limitations included a lower allowable percentage of meals, travel, and entertainment expenses. These were not massive changes in terms of percentages, but the amount of the deductions can add up substantially in large firms. The new limitation was 75% of these business-related expenses, which were at 85% in the previous year (CRS, 1985).

Taking into account all of these large corporate changes in tax structure, the Tax Foundation calculated the predicted economic effect (Muresianu and Pomerleau, 2018). This study found the change in tax revenue and the predicted long run impact in GDP for each provision that changed. For the lower corporate tax rate, the study found the reform decreased the annual tax revenue by over $24 billion and calculated it would increase the GDP in the long run by 3.31%. The extension of depreciation lives attributed to an increase in tax revenue of $8.2 billion and a -1.81% change in GDP. Lastly, the elimination of the investment tax credit for businesses attributed to an increase of tax revenue of $23.7 billion, with a -2.67% change in GDP. Even though the corporate tax rates decreased, the goal of the TRA of 1986 was to increase the corporate tax revenue.

The changes in the behavior of corporations that came before the implementation of the tax reform are also important. Immediately following the passing of the new tax code, firms were incentivized to defer income from the present year to later years since they could save in tax payments. They deferred income through accelerating expenses, meaning they raised expenses in the current year for possible costs that would usually

occur in the subsequent year. They also did this by spending more money on research and development, to lower their AGI (Scholes, Wilson, and Wolfson, 1992). Taxable income was also lowered through postponing sales by giving clients relief from payment or offering a discount if they paid their liabilities in future periods. On the flip side, if one firm defers income or accelerates expenses, the company on the other side of the transaction must do the opposite. This means if one company gets to defer getting paid to lower gross income, then the other company cannot expense the cost in the period leaving them with a higher income, which may not be tax beneficial for them. One of the expense areas that was not affected by an acceleration of recognition were the selling general and administrative expenses (Omer,1992). These are all direct and indirect expenses that come from selling and general administrative duties of the company, and are internal costs not associated with other companies. If these expenses are not accelerated, it proves the notion that external parties, rather than internal parties, are the ones being affected by extra expenses in a period.

Pass-through Entities

The largest change to S Corporations, otherwise known as pass-through entities, came from the individual reduction in tax rates since these businesses are not taxed at the business level. Rather, the owners of these companies are the ones who have the liability to pay the taxes. As stated previously, the highest marginal rate for individual filers dropped from 50% to 28% under the TRA of 1986. The change made these kinds of corporations more favorable, since the corporate tax rate only dropped to 34%. According to the Tax Foundation, the number of corporations filing under the pass-through domain increased 500% between 1980 and 2002, or from a total of 545,389 to 3.2 million

(Hodge, 2005). Following the tax reform, there were more S Corporations than regular C Corporations, much attributed to the favorable tax rates.

These pass-through entities were also subject to increased limitations brought on by the IRS to reduce tax shelters from passive loss activities by creating a limitation on net operating loss carryovers and credit carryovers. The passive activity loss limitation rules put restrictions on the ability of a taxpayer to use real estate or business losses to offset other income. This legislation introduced passive income. Passive income arises when a taxpayer owns a business and he/she does not materially participate in it. (Samwick, 1995). For a taxpayer to materially participate in the business, the 500-hour rule is used. They have to work 500 or more hours to be active in the business, but for real estate rentals, no matter how many hours they work they will still be considered obtaining passive income unless they are real estate professionals. To be a real estate professional one must spend 51% of their time working in real estate each year. With the new limitations, these passive losses can only offset income from passive sources, and there can be no excess loss deduction on the tax return. Instead, the taxpayer either has to dispose of the activity that generates the passive loss or generate enough passive income to offset the losses.

Economy

There are economic effects of decreasing tax liabilities for the upcoming years. Theoretically, there is less deadweight loss in the economy. The labor supply will also increase as more employees enter the workforce since the opportunity cost of not working increases as income tax rates are lower (Hausman and Poterba, 1987). This raises a recurring discussion from raising after-tax income between the income effect and

the substitution effect. The income effect says with a higher after-tax income, workers will be able to have more leisure and more consumption. One can work less and make the same amount of money or they can continue working and become richer which expands consumption. On the contrary, the substitution effect models how higher after-tax wages raises the cost of staying home (leisure). One then chooses to work more. These effects differ on what will happen when one's after-tax income rises, but the substitution effect dominates the income effect in the aggregate. This means from a macroeconomic perspective there is a greater incentive to work more hours when the after-tax wage rises. The result of the substitution effect is merely lessened from the income effect (Kimball and Shapiro, 2008). Therefore, the higher after-tax wage should raise labor supply.

Not only were there changes in behaviors for filers themselves, secondary earners, or the individuals who are working but earn less than their partners, also have reason to change their work behavior. With a higher after-tax wage, the secondary earners have a higher incentive to work more hours or to join the workforce. Looking at economic during this time, there was a significant increase in civilian employment. In 1986, the number of employed people increased by 2.1 million, and of these, 1.4 million were adult women (Shank and Haugen, 1987). This is important to note since secondary earners tend to be the women in the partnership. Along with a rise in employment, the weekly hours worked also increased. In 1986, the average workweek was 40.6 hours, which was the highest since 1973. The overtime hours in a week for a factory were also at 3.5 hours per week which was also higher than average.

Another criterion used to examine the economic impact of tax reform is the difference in overall federal receipts of taxes paid. There was a $122 billion decrease in

tax revenue from the years 1987-1991. The reform cut taxes in the aggregate, even though some groups' taxes may have been cut more. The percentage of federal tax receipts compared to GDP also fell. In 1985, the year before the new tax code implementation, the tax receipts were 17.2% of GDP. In 1986, the year the changes first started to take effect, the receipts decreased to 17% of GDP. As time went on, more of the tax changes were brought into full effect and as this happened, the tax receipts compared to GDP rose each year until 1991. These calculations relating to the federal receipts came from the White House historical tables.

The last criterion used to study the effects of the tax reform is the way GDP was affected. The impact on GDP is a crucial benchmark when used to measure the growth or decline of an economy. According to data from the World Bank, the GDP in the U.S. shrunk in 1980 and 1982 at -0.257% and -1.803%, respectively. This is important to note since the poor economic condition contributed to the passing of the reform. Then, in 1985 the growth rate was 4.170%, in 1986 the growth was 3.463%, and in 1987 the growth was 3.460%, all of which are classified as sustainable growth periods. After this time, the GDP growth rate rose to over 4% in 1988 and then sank to below 2% by 1990 (Data from World Bank, 2020).

3. *The Bush Tax Cuts Act*

The Bush Tax Cuts Act were a series of smaller tax changes throughout 2001-2003 under President George W. Bush's administration. Congressmen Bill Bradley and Senator Ron Wyden urged President Bush to enact a real tax reform for the American people since the public believed the Tax Reform Act of 1986 was not successful in doing

that (Chamberlain, 2006). These tax acts were called the Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRA). The tax bracket percentages were decreased in every income threshold except for the bracket of $68,000 to $137,000. Not only were the marginal rates decreased, but the tax change also raised the child tax credit from $500-$1000 for each qualifying dependent under the child or relative doctrine (Horton, 2017). The Bush Tax Cuts Act also had a reputation of helping out the top earners to a higher degree than the middle- or lower-income households. According to the National Bureau of Economic Research, the households that had an income of at least $570,000 had an increase in after-tax income of 5% on average while the households in the the bottom brackets saw only a 1% increase in their after-tax income (Horton, 2017).

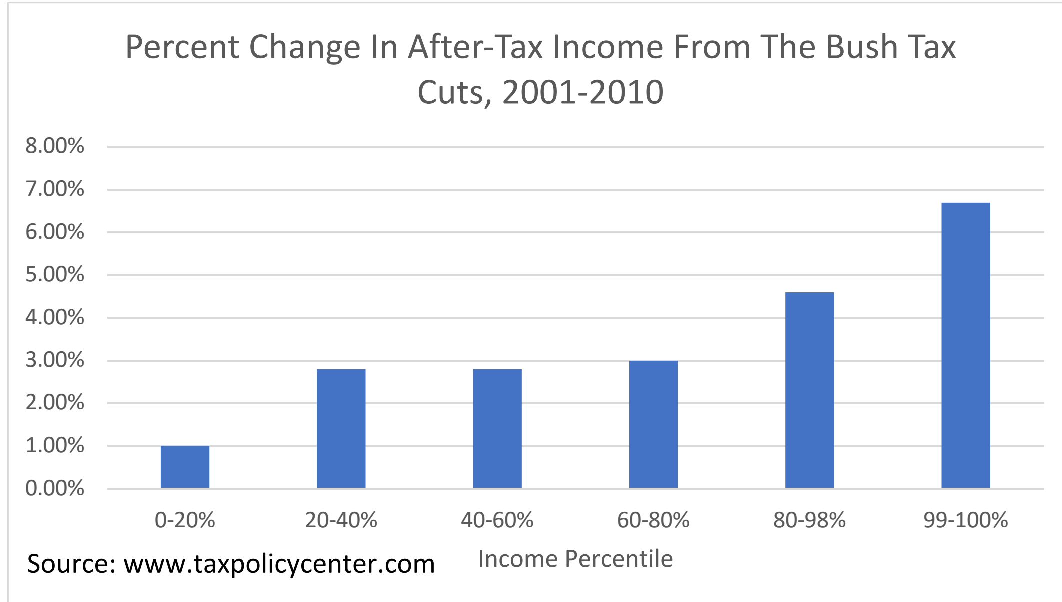
When President Bush came into office, there was a projected governmental budget surplus of $5.6 trillion for the next ten years (Potter and Gale, 2002). Historically, the government doesn't want to have a surplus in the budget since the extra money will not be working towards making more money or increasing GDP growth. This money could be used in many ways, but in this instance, the money was used to decrease government tax receipts to increase consumers' after-tax income in an attempt to increase spending within the economy. This surplus was the main argument for a tax cut since the government could afford a decrease in tax revenue in the years ahead. However, some professionals believe this number was quite off. They say this "budget ignores the long-term costs of retirement programs such as Social Security, Medicare, and government pensions," and the budget "assumes 35 million taxpayers will face the AMT in 2010, which few people believe will occur" (Potter and Gale, 2002). With these different

computations implemented into the budget, the surplus fell to just $1.6 trillion. With all of these tax law changes from 2001-2003, the tax cuts cost the government about $2.2 trillion or 2% of the GDP through 2011 and are said to have ended up raising the national debt in the long run.

Low income

Much like the TRA of 1986, the Bush Tax Cuts Act raised the allowable amount for the child tax credit and the earned income tax credit. This benefitted the low-income earners because almost all of the earners within the low-income bracket level were able to take this credit, especially with the higher phase-out limit in place. The increasing ability to take these credits affects the low-income population to a higher degree than the higher-income, since $500 to $1,000 is a higher percentage to someone with low income compared to someone with a higher income. The child tax credit was increased to $1,000 from $600 (Carr and Quinn, 2003). Additionally, there was a new 10% bracket that was made out of the 15% bracket, which is the lowest threshold. These changes made it possible for these tax cuts to be characterized as being for the working class. However, as time has passed, the long-term effects of the tax cuts were characterized as being for the wealthy. The Tax Policy Center has data to show that by 2010 when the tax cuts were fully phased in, the top quintile of earners had a 4.6% increase in after-tax income, while the bottom quintile earners received the smallest tax cuts, increasing 1.0% in after-tax income (Horton, 2017). This study also proved that the bottom four-fifths of households lost more than they gained from the tax cuts. Once again, the problem arose surrounding upper earner taxpayers' treatment being more beneficial than the lower earners' treatment.

Figure 3



To go back to the goal of the tax cut, to increase consumers' after-tax income which would in turn increase aggregate spending, the lower income levels and those with low liquid amount of assets spent their money much quicker than the middle earners. There can be several reasons for this, however, individuals who do not have much money tend to spend their money on non-durable goods and food, even within the first three months of receiving the check. According to the National Bureau of Economic Research, low-income households spent 62% more of their rebate on nondurable goods than they typically would have if they did not receive the refund checks (Johnson, Parker and Souleles, 2004). This is important because the purpose of the tax legislation was meant to increase spending in the economy to aid in GDP growth.

Middle income

As can be seen from Figure 2, the middle earners saw more changes in their after-tax income than the low earners saw, but still less than the high earners. A significant amount of these changes were tax savings that arose from the differences in percentage points for their respective bracket. There were little to no deductions or increases in credits that were enacted that affect the middle-earners significantly. This is contradictory to the saying these were middle-earners tax cuts. The increased child tax credit from $500 to $1,000 per child and their extended limitations was one of the areas that did help these taxpayers, but only to a small degree since many taxpayers were subject to phase out from income limits. With the slight increase in the child tax credit eligibility, the marriage penalty would be lessened to a small degree, which was one of the objectives of these tax cuts. The marriage penalty is characterized by married couples who have to pay higher taxes than if they were two otherwise single taxpayers who made the same income. This "penalty" gets larger as the income increases for each taxpayer. To illustrate, in the year 2000, before the tax cuts were enacted, if two taxpayers each had a taxable income at $165,000, their respective tax liabilities would be $47,451. Now, if the same two taxpayers were married and filed jointly their total tax liability would be $103,348 together or $51,674 each, which is 8.8% higher than if they both had separately filed as single. This penalty is a problem that recurs in almost all tax years, which gave the rise for taxpayers to file as married filing separately.

Looking again at the effectiveness of the tax cuts towards one of the primary goals of increasing aggregate expenditure as a use for a budget surplus, the middle-earners was the income group that did not use the money to increase spending. This

income group saw the most amount of personal and capital savings from the amount of tax savings they incurred (Johnson, Parker, and Souleles, 2004). The reason for an increase in savings is because they didn't necessarily need the money immediately nor wanted to spend the rebate money on things they didn't need. They chose to use the money to benefit their future, whether it was put in retirement or other kinds of saving accounts. In any way, the rebate money was not put back into the economy immediately to help in the growth of GDP through increased spending.

High income

The Bush Tax Cuts Act was most beneficial to the high-income taxpayers. They were better off from the tax cuts, with the top 1 percent of households, those who were at $570,000 and above, increasing their after-tax income by 4.6% percent each year. The plan was to decrease the wealthy taxpayers' income tax liability to the highest degree because the high earners can affect the economy to the highest degree. In general, the high-income earners or those with high levels of liquid assets tend to spend their refund money more quickly than the middle-earners. This money is extra, they do not need the money to cover their ordinary expenses. Even though the money was spent quickly like the low-earners, it was spent on luxury goods. This income group was able to make a large effect on the aggregate spending in the economy.

Even though the high-income taxpayers benefitted greatly under the normal income tax calculation, there is another income tax calculation used for many top earners called the alternative minimum tax (AMT), which is not preferential. One of the ways in which high-income earners were affected negatively is the number of taxpayers who faced the AMT. Even though the AMT rules did not alter significantly, the tax started to

affect more high-income earners. The AMT provision is a mandatory alternative to the normal income tax, which is triggered when a taxpayer has a high AGI. The Balance, a financial advice and news website, says, “The AMT produces around $60 billion a year in federal taxes from the top 1% of taxpayers” (Amadeo, 2020). The tax works in this way: once a taxpayer hits an income threshold, many itemized deductions are eliminated, and new tax liability is created. Once the amount is found, it is compared with the common income tax calculation and the greater of the two amounts is the amount owed. Before the Bush Tax Cuts Act, the AMT was only affected by the taxpayers who had one million dollars or more in taxable income. The way the two tax calculations were set up was so the households who had six figures in taxable income usually saw a larger tax liability under the normal tax. Now, with the tax rates lowered, more taxpayers will be affected by the AMT tax. According to Samara Potter and William Gale, “the tax act raises the number of taxpayers who will face the AMT to 35 million in 2010. About 2 million taxpayers face the AMT currently, and 18 million would have in 2010 under previous law” (Potter and Gale, 2002). This concludes the income threshold, even though there is not a set-in-stone amount, is lowered for the people who must follow the provisions of this alternative tax method, and in turn, will owe similar taxes as before the cuts were enacted. All things considered, the high-income earners may not have been treated as nicely under the Bush Tax Cuts Act as what some people thought.

Another change that will affect all taxpayers but especially the higher income earners is the personal exemptions phaseout limit (PEP) deletion. With the phaseout being eliminated under the Bush Tax Cuts Act, all taxpayers can take this exemption. Previously, the exemption could not be taken by taxpayers who had a taxable income at

or above $250,000 (Thomas, 2013). Going along with the PEP rules is the Pease limitation rule for itemized deductions. This rule reduces the amount in itemized deductions for high-income taxpayers, and it was also eliminated under the Bush Tax Cuts Act. The Pease limitation rule used to apply at a taxable income of at least $250,000, as well. With both of these phaseout rules eliminated, high-income earners were able to subtract more income from their taxable income and contribute to their lowered tax liability.

The last change that benefitted the high-income earners from the Bush Tax Cuts Act is the decrease in the long-term capital gains rate. Unlike the TRA of 1986, the capital gains rate decreased, which helped these earners the most. As discussed in the TRA of 1986 section, this income group had the highest amount of capital gains to pay taxes on, by a large margin. These new rates were preferential and decreased the overall tax liability during this time. The reason for decreasing these rates will be discussed later in the corporations' section.

Corporations

The JGTRRA was enacted in 2003 following the recession of 2001 and the 9/11 attacks. This specific tax cut was passed to spur the economy with its focus mainly on corporations. The goal of the Act was to boost the economy by decreasing the amount of tax investors paid on dividends and capital gains to give corporations an incentive to pay dividends instead of holding on to cash, which would stimulate the economy. The details surrounding these ideals were the rates and the character at which recognized long-term capital gains would be taxed. First of all, the character for taxation on dividends was changed from ordinary to long-term capital gains rates, which is preferential in many

instances. The long-term capital gains tax rate was reduced from 20% to 15% for higher earning taxpayers and it reduced the rates to 5% and zero for taxpayers in the 10% to 15% income tax brackets in 2008 (Amadeo, 2019). The effect of these preferential rates for dividends and capital gains caused corporations to increase dividend payments. A notable corporation that began to pay dividends during this time was Microsoft, one of the largest corporations in the world. As a result, between the years 2003 to 2012, dividend payments increased by 20% (Amadeo, 2019). By increasing dividend payments, investors were more likely to purchase dividend-paying stocks thus boosting the companies that paid dividends profitability and market share size.

Boosting dividend-paying corporations' profitability proved to be successful by raising the GDP growth rate to 6.73% in 2004, which some say was part of the reasons behind the 2008 recession. This rate of GDP growth is extremely high, and the economy sometimes cannot handle it. The ideal rate for GDP growth is somewhere between 2-3% and if the growth gets much higher, the economy can "overheat," (Amadeo, 2020). This can be seen precisely in the economy right after the years following the extremely high GDP growth rate. This resulted in too many investments in the housing market near 2008.

Another extension of the JGTRRA deals with depreciation, specifically bonus depreciation and section 179 immediate expensing. Bonus depreciation refers to the amount allowable for a business to immediately write off, as a deduction, eligible property instead of using the useful life approach. In the same light, section 179 from the tax code deals with immediate expensing, which is another alternative to the normal useful life approach to deprecation. This section allows a business to deduct certain property as an expense rather than capitalizing it and then deprecating it. Under the

JGTRRA, property acquired after May 5, 2003, and before January 1, 2005 had an increase in the allowable amount for bonus depreciation from 30% to 50%. Lastly, the immediate expensing limit increased from $25,000 to $100,000 for property placed in service in 2003, 2004, and 2005 (Carr and Quinn, 2003). This change allowed corporations to increase deductions and lower their taxable income by a significant amount.

Pass-through Entities

The section of the tax cuts focused on small businesses also came from the JGTRRA. There were not many changes with this legislation that affected S corporations. However, as these are pass-through entities, the owners are still affected by the individual tax changes that came from the Bush Tax Cuts Act. These businesses benefitted with lower tax liabilities due to the more favorable depreciation allocations. The JGTRRA increased the reduction rate that assets could be depreciated, as well as, the amount that could be immediately deducted under section 179, just like corporations. Section 179's depreciation was expanded to allow a deduction of $100,000 instead of $25,000 under the pre-JGTRRA law. Additionally, section 179 has a spending limit that was doubled from $200,000 to $400,000. This spending limit was a restriction for the assets being purchased and if the amount of the purchase was over the amount, then the deduction was reduced on a dollar per dollar basis (Carr and Quinn, 2003). The last segment of section 179 that was changed to favor the taxpayer was the property defined as qualified was expanded to include "off-the-shelf computer software" (Carr and Quinn, 2003), which had not been qualified, and therefore, did not apply to section 179's favorable depreciation allocation. These expanded limits allowed the business to decrease taxable

income at a quicker rate than before and incentivized them to acquire more qualified property. The last area of depreciation that was changed under the Bush Tax Cuts Act was bonus depreciation. Starting with assets placed in service "after May 5, 2003, and before January 1, 2005, the bonus depreciation deduction increased to 50% from 30% for qualified property" (Carr and Quinn, 2003). There is no spending limit attached to bonus depreciation and the definition of qualified property was not changed.

Economy

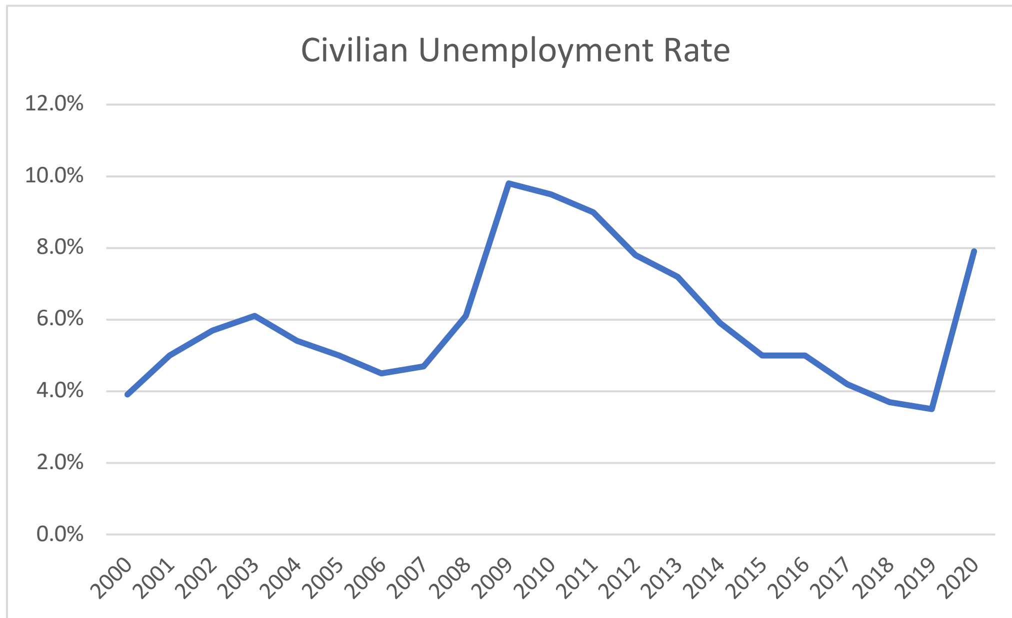
In general, the decision as to raise, keep the same, or lower the tax percentages and overall tax liabilities to households and businesses comes down to whether or not the policymakers want to grow the economy through increased governmental income tax revenue or through society spending more money as a result of raising after-tax income. The economy can grow through having higher taxes owed by individuals and corporations, which directly increases government revenue. The extra revenue can be used for infrastructure, capital, and investments. As a result, workers will become more productive and the overall living conditions will increase. In turn, this will expand the economy. On the contrary, lowering tax liabilities can influence many decisions in theory. Employees will have an incentive to become more productive because they are taking home more after-tax income for every dollar they earn. This will cause an increase in corporate profits as well. It is also shown they will have an incentive to produce higher savings, investments, and entrepreneurship, all of which contribute to a growing economy (Myles, 2007). The question is not which one grows the economy since both of them have been shown to do so in the past, it is which method produces the best results of growing the economy.

Looking at the GDP output and growth each year can prove to be a worthy statistic of illustrating the success of an economy. According to the World Bank Group, the GDP grew at 4.13% in 2000, immediately before the implementation of the tax cuts and before the 2001 recession. In 2001, the GDP fell to a growth of 0.99% but then immediately went back to a growth of 1.74% in 2002. In the next five years, the GDP growth was 2.86%, 3.80%, 3.51%, the years just before the recession of 2008 (Data from World Bank, 2020). Numerous factors contributed to the high growth, one of the factors being the tax cuts from 2001 and 2003, which made the cost of capital less expensive. As stated previously, with tax cuts there is also a theory that decisions will be affected on the supply side of labor. Simply put, it becomes more expensive not to work and incentivizes more productivity within the economy. Shortly after the growth period came a recession where the GDP shrunk by 2.11% in 2009. Many say the 2008 recession came about because the GDP growth in the years before the stock crash was too high and caused the economy to overheat.

Another economic criterion used in an analysis to provide data on the wellbeing of such an economy is the unemployment rate. Figure 4 is from data at the U.S. Bureau of Labor Statistics and it displays the civilian unemployment rate starting in September of 2000 until September of 2020. As can be seen, during 2001, there was a recession which led to an increase in the unemployment rate. This recession is one of the reasons the 2003 tax cuts were implemented. The economy needed a boost, and tax cuts were decided to be the way to do this. In July of 2003, the unemployment rate hit its peak for this cycle at 6.3% but then decreased until 2007, when another recession hit. The tax cuts signed by the Bush administration, the first one passed in 2001 and the second in 2003, follows the

graph perfectly. Figure 4 also proves that some of the changes implemented at least played a factor in contributing to more people being employed in the economy.

Figure 4



Source: U.S. Bureau of Labor Statistics

Going along with the unemployment rate is the participation rate. According to The Center on Budget and Policy Priorities, the male labor participation was barely affected by the decrease in tax rates, but female labor force participation was more responsive. This ties closely to the results of the TRA of 1986. The females worked more hours and had more participation in the workforce. Also, the average male retirement age went slightly up as well, which means older men worked longer on average (Orszag, 2001).

The last economic criterion is the overall GDP growth and the federal tax receipts compared to the GDP. From 2000-2004 the tax receipts compared to GDP fell four percentage points to only 18.2% of GDP, which is the lowest this statistic had been since the years following the passing of the TRA of 1986 (Potter and Gale, 2002). Furthermore,

in 2000 the government had a 2.3% surplus, while in 2004 they had a 3.4% deficit. However, part of this change can be attributed to an increase in the federal budget of 1.4%, according to the White House Historical Tables.

It is beneficial to look at where the extra rebate money from taxes went within the economy and to see the behavior of taxpayers. Overall, within three months of the tax rebate from the Bush Tax Cuts Act, there was an increased expenditure of 11% on food, 24% on nondurable goods, and 37% on nondurable goods when it is more broadly defined (Johnson, Parker and Souleles, 2004). Nondurable goods are defined as products that are only useable for a short period of time for this calculation. The aggregate expenditure within the economy increased by 0.8% in the third quarter of 2001 and 0.6% in the fourth quarter of 2001, also found from the same study. This study also found that in the long run, the rise in expenditure from the rebates decayed as time went on. In other words, the money was spent quickly and did not have a significant lasting effect on the economy. It is easy to look back at the effects and question if these rebates were worth the astounding ten-year cost of $2.1 trillion from these tax rebates and tax cuts presented in the Bush era.

In general, there is not significant data to prove that different tax rate percentages and tax provisions contributed heavily to producing a growing economy. Income taxes are only a small part of the equation of what constitutes the size of an economy. Equally important, with incentives that come from decreasing tax rates, there is always another side to the transaction that has to offset it. The income effect mitigates the substitution effect. If an individual, household, or business is content with their living and income

situation they have no reason to earn more money, they will have decreasing returns with longer hours put in.

4. *The Tax Cuts and Jobs Act*

The most recent tax reform was passed in 2017 called the Tax Cuts and Jobs Act (TCJA). This reform was passed under the Trump administration in an attempt to simplify the tax code and reduce tax liabilities for much of the working public. The TCJA has been estimated to cost the U.S. government $1.5 trillion (Kess, 2018). President Trump reasoned for the enactment of the TCJA primarily to stimulate the economy in the short run. Learning from previous tax code implementation, lower corporate tax rates have led to solid economic growth, however, in the TRA of 1986 and the Bush Tax Cuts Act, top earners benefitted in a much larger way than the middle and low income groups. This new code is meant to simplify the tax process and decrease overall tax payments from individuals of all income groups and raise taxable incomes of corporations. In theory, these results would come from fewer loopholes in the tax code with the overall simplification for the process of taxing income. In general, all income is subject to tax unless there is a specific exception. Moreover, if corporate reported income is shifted back to the United States instead of overseas, the number of tax dollars received would be increased.

The TCJA is meant to simplify the tax process in an attempt to reduce the number of loopholes taken by large companies. Lower corporate rates have been the trend in the G7 countries. The G7 countries are the seven countries to have the most advanced economies in the world, Canada, France, Germany, Italy, Japan, the United Kingdom,

and the United States. However, the United States has been the only country out of the seven to not have low corporate tax rates. Since the tax rates have previously been lower in other countries, many corporations have recognized income in a foreign location that may be earned in the United States. This can be seen from the high value of foreign-source income credits. For instance, according to Apple's 2017 form 10-k reports, Apple only had a 24.6% effective tax rate (p. 56). The difference between Apple's rate and the 35 percent United States rate is, "indefinitely reinvested earnings of foreign subsidiaries" (pg. 28).

According to the 2018 Economic Report of the President, the TCJA sought "tax relief for middle-income families, to simplify the tax code, to boost economic growth through business taxation relief, and the repatriation of overseas earnings." With this in mind, the bill aligned with past law changes the way it sought to decrease tax liabilities in the economy to give incentives to increase expenditure from higher after-tax incomes. The law impacted many sections within the IRS's tax code, but the largest changes discussed are the changes in individual and business tax rates, the deductibility of itemized deductions, excess business loss treatment, code section 179 immediate expensing, 100% bonus depreciation, code section 1031 treatment of personal assets, the elimination of the personal exemption, and an increase in the child tax credit. Some provisions arise from the fourth goal stated above, the repatriation of overseas earnings, however, this paper focuses on the domestic business changes from the tax provision.

Since the TCJA was passed merely two tax years before this discussion, there is not sufficient data to conclude the effectiveness of the changes nor the long-term effect it will have on the economy. However, there were some differences seen before the passing

of the law in 2017. With the reduction in the corporate tax rate in effect for tax years beginning in 2018, corporations knew they could save in taxes by way of the timing of expenses and revenues. With this in mind, there was a significant number of entities who increased expenses and deferred income in the current year, to minimize taxable income and shift much of the income to the 2018 tax year where the income would be taxed at a lower rate. Additionally, many leading corporations such as AT&T, Comcast NBC, Boeing, and Southwest Airlines all announced plans to give $1,000 bonuses to more than 300,000 employees and the tax cuts in the future were the reason (Powell, 2018). Moreover, the stock market closed out in 2017 with a record increase in growth for a record 8th straight year (Powell, 2018). In general, members of society are preparing to pay fewer taxes, therefore, an increase in disposable income, which already affected individual and business decisions even before the TCJA had been passed.

Low income

Theoretically, a large amount of the low-income tax filers from the years before the TCJA provisions were implemented will no longer need to file a tax return because of the significant rise in the standard deduction. This is part of the simplification of the tax code. The TCJA increased the standard deduction amount from $6,350 in 2016 to $12,000 in 2017. To offset the increase in the standard deduction amount for each filing status, the personal exemption and the earned income credit were eliminated. Each of these tax systems were meant to benefit the working population and reduce the taxable income amount which many, if not all, low-income filers took in prior years. Many filers would not have had to file a return due to the fact their income did not meet the threshold but would have had to file to take the exclusion and credit. Another way the IRS sought

to offset the rise in the standard deduction amount was through the limitations to itemized deductions including the elimination of the 2% miscellaneous itemized deductions. These limitations would not affect the vast majority of low-income taxpayers, however, as many have not previously itemized.

The other way the IRS sought to reduce tax liability was through a reduction in tax rate percentages for each tax bracket. This can be seen in Table 2. The low-income group was said to be “25,624 in 2016,” which means the average low-income household saw only a small reduction in tax saving directly from the decrease in percentage (Elkins, 2019). To use this taxable income amount to use as an example under the TCJA. The taxpayer, if single, would take the standard deduction in 2018 of $12,000, then have $13,624 left. Of this amount, $9,525 would be taxed at 10% and the remaining $4,099 would be taxed at 12%, assuming there are no other credits or deductions taken. With this calculation, the taxpayer would have a tax liability of $1,444. Previously the same taxpayer would have had a tax liability of $2,425 with the standard deduction at the previous $6,350 and the associated tax rate percentages. The amount owed is nearly doubled under the old tax code, which shows the TCJA is beneficial to the lower eaners under these assumptions. This is theoretical since there is not sufficient data to conclude the results of the actual savings.

Another rule adjustment of the TCJA was made to the child tax credit. The credit is now worth up to $2,000 per qualifying child, up from $1,000 in 2017. In the past, there was no limit to how much of the credit was refundable, but now there is a limitation of $1,400. Additionally, there is an earned income threshold of $2,500, which was also not present before the tax reform of 2017. Even though there are some added limitations, the

credit was increased enough to still benefit low-income filers. All in all, there are many adjustments made to the tax process that will benefit each income group. However, there is still short-term evidence that shows as one earns more money the more benefits one will see from the TCJA.

Table 2

Tax Brackets for Single Filers Under the TCJA

2017		2018	
10%	$0-$9,325	10%	$0-$9,525
15%	$9,326-$37,950	12%	$9,526-$38,700
25%	$37,951-$91,900	22%	$38,701-$82,500
28%	$91,901-$191,650	24%	$82,501-$157,500
33%	$191,651-$416,700	32%	$157,501-$200,000
35%	$416,701-$418,400	35%	$200,001-$500,000
39.60%	$418,401 or more	37%	$500,001 or more

Source: KDP LLP

Middle income

By nearly doubling the standard deduction, 2% miscellaneous deductions ending, and other itemized deduction limitations, the middle earners will reap the benefits of the higher standard deduction. Many of the taxpayers in this income group will not have enough itemized deductions, which is where many of the new limitations took place. A decrease in the number of taxpayers who itemize is meant to both simplify the tax preparing process, as well as to lower tax liability for middle to low-income taxpayers. From the same chart above, the income group that makes the median salary, $63,179 in 2018 according to the U.S. Census, will see a 3% decrease in the tax rate from the prior years. Along with this, the middle earners benefitted from the child tax credit increase because the child tax credit not only doubled but the phase-out limit was set at a high dollar amount.

As stated previously, the personal casualty and theft losses are subject to the 2% limit of AGI as part of the miscellaneous itemized deductions and can no longer be deducted starting in 2018. Under the TCJA, these casualty losses have to be a part of a federally declared disaster area from the President and are now subject to a $100 floor and a 10% limit of AGI to be deducted. Another aspect of schedule A on form 1040 is the lower limit for the home mortgage interest deduction (HMID). This deduction can be taken by taxpayers "who choose to itemize and can deduct interest paid up to $750,000 worth of principal, on either their first or second residence" (Eastman and Tyger, 2019). Before the TCJA, the limit was $1 million, and it will revert to this amount after 2025. If the principal is over the $750,000 amount, these taxpayers may still deduct a percentage of the total interest paid, based on how much over the amount is. The particularly wealthy taxpayers will be more affected by the limit change since the limit is set at a high dollar amount and other income groups do not usually own homes exceeding the old limit of $750,000. On the other hand, the benefits of this deduction are largely taken by high-income taxpayers and will increase in proportion even more, since fewer taxpayers will itemize. This means that middle income taxpayers will see even fewer benefits from this deduction in future years.

High income

The upper income group should see some tax reduction simply from the lower tax bracket percentages implemented. Additionally, they will benefit from the increase in the standard deduction, but not as much as other income groups. To illustrate, high-income taxpayers will not see as large of a benefit from a standard deduction increase of less than $6,000 for single filers as would someone closer to the deduction limit. The standard

deduction increase is the only way the high-income earners will be affected less than other income groups. According to the Tax Policy Center, “the more money you made, the bigger your tax cut on average—both in dollars and as a share of your after-tax income” (Gleckman, 2019). This article also pointed to the fact that the TCJA had 65% of households paying less money in taxes in 2018, only 6% paid more, and the rest were the same. On average, the high-income households who made more than $733,000, also known as the one percenters, saved $33,000 in taxes. With all of these savings and the fact that the high earners account for nearly forty percent of the U.S.’s income, the high-income earners could be putting a significant amount of money back into the economy (Sommeiller and Price, 2018).

As stated previously, since the overall percentages of taxes decreased, the deductibility of losses were given new restrictions. Starting in 2018, there is a new limit of $10,000 per year for local real estate and personal property taxes and either income taxes or sales taxes, known as the state and local tax (SALT) deduction. This deduction can be taken by taxpayers who itemize. According to the Tax Policy Center’s Briefing Book, “the SALT deduction was a large federal tax expenditure, with an estimated cost of $100.9 billion in 2017.” With fewer taxpayers itemizing under the new provisions, the deduction amount dropped to $21.2 billion in 2019. The taxpayers who claim the SALT deduction was more likely high-income households than low- or moderate-income households. Before 2018, 90% of tax filers with income levels above $200,000 took this deduction. However, under the TCJA, the tax savings dramatically fell: “the tax savings from the SALT deduction in 2018 was about one-quarter of what it was in 2017 overall.”

For taxpayers in the top one percent of the income distribution, the tax saving in 2018 was about one-tenth of the tax-savings in 2017" (Tax Policy Center, 2020).

Another way the high-income taxpayers will have more restrictions on deducting losses is through the added restrictions on the passive activity loss rules (PAL). In the 1980s, before any of the tax legislation regarding passive income occurred, "some wealthy individuals invested in real estate limited partnerships and other tax shelters created solely to generate large losses… investors use their paper losses to offset their other real income" (Fishman, 2018). However, in 1986 the passive activity loss rules were made to limit taxpayers' ability to deduct losses in rental properties and businesses the taxpayer did not materially participate in. There is a 500-hour test used to determine if a taxpayer was a material participant in the business, but for real estate companies there was an even more stringent test that made the taxpayer participate 51% of their time so they would be known as a "real estate professional." The TCJA did not change these rules, however, they added restrictions that only let the material participants or real estate professionals deduct $250,000 as a single filer or $500,000 if married filing jointly. These rules are the excess business loss rules and are indulged more in the pass-through entities section.

The alternative minimum tax calculation also had some changes within the TCJA. There was projected to be a decrease in both the number of taxpayers affected and the tax receipts from this tax treatment by a significant amount. This decrease was predicted because the exemption amount increased from $54,300 in 2017 to $72,900 in 2018 and the phaseout threshold increased from $120,700 to $518,400 for 2017 and 2020, respectively, all for single filers (Amadeo, 2020). However, data has been shown that this

is not the case, as the number of filers subject to the AMT tax has gone up since the tax changes, as can be seen from Table 3.

Table 3

Year	AMT Taxpayers	Year	AMT Taxpayers
2010	4.6	2016	4.9
2011	4.5	2017	5.2
2012	4.6	2018	5.4
2013	4.2	2019*	5.6
2014	4.5	2020*	5.6
2015	4.6	2021*	5.7

Source:www.taxpolicycenter.com
* projections

Lastly, the decrease in filers affected by the AMT is due to the changes made to the personal exemption, the SALT deduction, and the miscellaneous deductions, since these were all more preferable tax treatments than the AMT, according to the Tax Policy Center (2020). This is important to high-income filers because the AMT is a separate tax calculation meant to increase tax liabilities for those subject to it. This is another way the high-income group will overall see a decrease in taxes owed, at least until the changes expire in 2025.

Corporations

One of the biggest changes seen in the TCJA is the new 21% flat tax rate for regular corporations. In 2017, corporations had as high as a 38% tax rate, which is near double what they currently have to pay. This reduction results in massive savings and different decisions firms will make going forward. As C corporations tax rates have gone down a significant amount, the S corporations, or small business flow-through entities, have also decreased their tax rates. If these rates did not go down as well, then many

companies would form a C corporation for its tax incentives. For this reason, the TCJA added a new deduction that can be taken from these entities called the qualified business income (QBI) deduction. This deduction is from section 199a of the IRS code and it allows taxpayers to deduct a percentage of income if they are structured as pass-through entities. With this change, these smaller entities will increase their after-tax incomes in the same manner as corporations will.

Another change seen in the corporation's treatment of tax liability is the increase in the section 179 deduction. This deduction is for the full purchase price of qualifying equipment from taxes. They increased the first year write-off to $1,000,000 from the old limit of $500,000 in 2016. With the increase in the first year write-off abilities, there will be an increase in capital acquisitions in the next couple of years to take advantage of this incentive before it is set to phase out. Along with this, the TCJA enacted bonus depreciation to 100% of the price of equipment and now includes used equipment. Allowing businesses to apply these depreciation methods can help lower their net incomes for the fiscal year, therefore, lowering the amount in taxes. Overall, these two changes are put into place to incentivize companies to invest in themselves. This is part of Trump's idea to obtain long term economic growth for the future. If firms purchase large pieces of capital or fixed assets in the short term, the long-term effects will be positive.

Another way assets are affected under the TCJA is through the treatment of like-kind exchanges under section 1031 of the IRS tax code. Like-kind exchanges are a way to defer gain on real or personal property if not sold. Rather, this property is exchanged for property of like-kind nature, as long as it was used for business purposes or the

production of income. For example, an entity could swap an apartment building for a strip mall or one investment property for many replacement properties. In general, the IRS was flexible with what a like-kind exchange was defined as. However, after the passing of the TCJA, like-kind exchanges were eliminated for exchanges of personal property. In the IRS's eyes, it is not fair to let entities deduct the cost of assets under section 179 and 100% bonus depreciation and also allow them to defer a gain under a 1031 exchange (LeBlanc, 2018).

Pass-through Entities

One of the biggest changes to flow through entities after the passing of the TCJA is the new limit for excess business losses. This limit was passed to expose sheltered income within large losses in a year. The new limit is $250,000 loss for single filers and $500,000 for those filed jointly in 2018. If there is any excess loss once the limit is hit, it may be carried forward for future years, however, the net operating loss will only be able to offset 80% of taxable income for the subsequent years. The new legislation works as such: if you have $500,000 in net loss, $300,000 in interest and dividend gains, and $100,000 income, you are now limited to a $250,000 loss instead of the $400,000 loss that would have arisen in this situation. The new limitation will likely only affect the wealthier individuals who use a flow-through entity as a tax shelter against large incomes. The large losses can arise from purchasing new equipment and electing to depreciate it immediately. In other words, S Corporations, partnerships, and sole proprietorships tend to operate to make money instead of losing money to shield against other incomes, so this rule will not affect much of the majority of taxpayers.

There is a new deduction from AGI that can be taken even if a taxpayer does not itemize for pass-through entities. As stated earlier, this deduction is meant to coincide with the regular corporations reduced flat tax rate. This deduction is for qualified businesses that allow a “deduction up to 20% of qualified business income (QBI) from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust, or estate” (Schreiber, Bonner, Nevius, 2019). It is subject to phase out as one’s AGI hits a threshold of $160,700 for single taxpayers and $321,400 for married taxpayers. Once these limits are hit, the deduction changes to the greater of 50% of W-2 wages or the sum of 25% of W-2 wages and 2.5% of the adjusted basis of all qualified property. With this change, these smaller entities will increase their after-tax income and therefore the pass-through individual incomes. This increase in disposable income can go directly into the economy through increased savings or spending. Additionally, these smaller businesses will invest more in the research and development of the company because they may increase expenses to meet the same level of income before the deduction. This promotes the long-term growth of the business, which in turn affects the long-term growth of the economy as a whole.

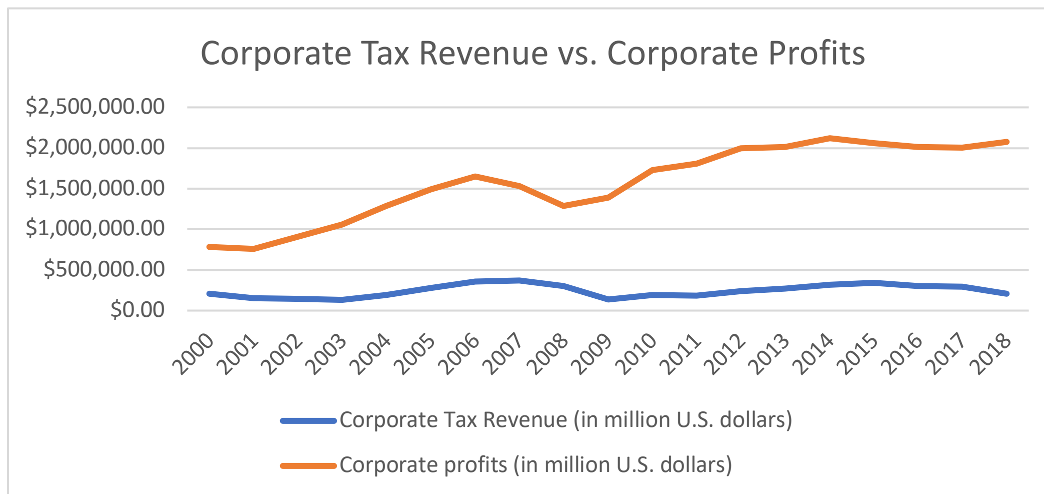
The QBI deduction cannot be earned through a C Corporation because congress believed this added deduction would be similar to the rate reduction of corporate income (Bonner, 2019). Other guidelines that inhibit the amount deducted are the net amount of the qualified elements of income, gains, deductions, and losses. This deduction will aid in the growth of the economy by giving low-income, small businesses a break in tax liability since the phaseout of income begins at $157,500 for single filers. Between the QBI deduction and the lowering of pass-through entity tax bracket percentages, small

businesses will receive a hefty tax break in the future. Out of all of the changes in the new laws, this may be the most controversial. President Trump believed in lowering tax rates for corporations to make American companies more competitive which would fuel economic growth. But only time will tell if this theory will become a reality with time.

Economy

According to the White House governmental budget data about tax receipt income versus the outlays in terms of GDP, the TCJA decreased tax receipts while GDP grew. In 2016, the year before the changes, the tax collections fell from 2015 they were at 18% of the GDP, while in 2016 and 2017 they were at 17.6% and 17.2%, respectively. Then, in 2018, the first year with the changes starting to phase in, the receipts went down almost an entire percent from the previous year, as only 16.4% of GDP. Based on the estimates up to 2025, when the tax reform is set to be phased in, the government will be in a deficit but at a decreasing amount each year. According to the Center for American Progress, the tax cuts towards corporations were even larger than calculated, even while profits were soaring (Hendricks and Hanlon, 2019). This can be seen from the graph below.

Figure 5



Source: Office of Management and Budget, Historical Tables

One of the reasons for the dramatic decrease in tax receipts is due to some of the provisions not phasing completing in until 2022 or later. Another reason is some of the tax breaks are merely temporary or a quick fix, such as immediate expensing. Companies are writing off capital expenditures quickly with the new tax code; however, this means the tax break is one-time rather than spreading the deduction over multiple years. Lastly, it is important to note profits are increasing, displaying a prosperous business setting, which is a major goal in the Trump administration for these tax cuts.

A major difference between the Bush Tax Cuts Act and the TCJA is the economic setting in which they occurred. The Bush Tax Cuts Act was implemented following a recession in 2001, while the TCJA was put in place when the economy was in an expansive phase of the business cycle. The TRA of 1986 also followed a recession dating back to 1981-1982. While these two past tax cuts followed a time when the economy needed a high growth period to "make up" downtimes, the TCJA was passed when the economy was averaging GDP growth of 3.82%, considered high by economists. Many professionals are fearful of tax cuts when the GDP is already growing at this rate may lead to another crisis like the 2008 recession. Immediately before the economic downturn, the GDP saw growth rates in the 6 percent range.

5. *Summary*

The three tax reforms discussed in this paper were described by how they affected income groups and business entities. Many of the provisions changed in each tax reform

targeted specific groups, and the provisions were looked at in the aggregate. Table 4 depicts the way each group was affected.

Table 4

Area of impact	The Tax Reform of 1986	The Bush Tax Cuts Act of 2001 and 2003	The Tax Cuts and Jobs Act of 2017
Low Income	Many provisions affect this income group; however, tax savings is not massive.	Not a significant amount of tax savings. These savings caused a short-term increase in spending.	A decrease in the number of filers in this income group. Many beneficial tax provisions to reduce tax liability.
Middle Income	This income group saw the least amount of savings. Many provisions affect them but none significantly.	Higher tax savings than low income but still less than high income. Rise in savings in this income group.	Benefit from same provisions as lower earners and increase in home mortgage interest deduction. Some new limitations on itemized deductions.
High Income	High-income earners saw the most significant savings from tax liability.	The largest change in after-tax income for any income group. More taxpayers subject to AMT.	Marginal rates did not decrease as much as other income groups, but there is still some data this income group will reap the most benefits.
Corporation	In theory was supposed to increase the tax on corporations, but this did not happen.	Lower dividend tax rates increased the corporation's dividend-paying stocks. Preferential treatment changes in depreciation.	Massive decrease in tax rate and also implemented a flat tax rate. Favorable depreciation treatment provisions.
Pass-Through	Saw new limitations, but individual rates were lower which led to an increase in this corporation structure.	Not many changes other than to the individual marginal rate decreases. Depreciation changes also affected this group.	A new deduction that aligns with a lower corporation tax rate. Limitations on losses and how they can be applied to different tax years.
Economy	Correlated with a time of higher GDP growth after a recession. Also, a lower unemployment rate.	Correlated with a lower unemployment rate and an increase in short run spending. There was a recession present after the 2001 tax act but after the 2003 tax act, there was a time of high GDP growth.	Not sufficient data to conclude the success of the tax reform. There are some early signs that it is successful in boosting the economy.

Table 4 summarizes the results found from the discussion. Each tax reform had many similarities in the areas of the tax calculation that they changed, however, each reform changed different aspects. For instance, the TRA of 1986 reduced the corporate tax rate, but individual tax rates were still reduced lower. This made more entities either convert to the pass-through business structure or new businesses start in this structure. The TCJA also reduced the corporate tax rate, but the reform also included the QBI deduction. This deduction made the pass-through business income tax similar and thus entities were not incentivized to convert solely for tax purposes. Another area that was targeted in both the TRA of 1986 and the Bush Tax Cuts Act was the capital gains tax rate. The TRA of 1986 increased the gains rate to equal the ordinary income rate, while the Bush Tax Cuts Act reduced this rate. The TRA of 1986 also targeted businesses' capacity to deduct depreciation by reducing the amount of depreciation taken each year since it lengthened the depreciation schedules. On the other hand, the TCJA increased both immediate expensing and the percentage of bonus depreciation that could be taken. This made it possible to deduct a large amount if not all the depreciation of certain qualifying assets. Lastly, it is evident these reforms moved to disallow certain losses used to offset income as a way of tax sheltering. The TRA of 1986 introduced the passive activity rules to limit losses on certain types of income, while the TCJA went even further by only allowing the loss carryovers to offset only 80% of future taxable income.

All three reforms correlated with higher GDP growth shortly after the implementation, but there were still recessions in the economy following each one. Economies are meant to go through cycles and there will be recessions in the future.

Having the most fair tax code will not prevent them. Tax reform can be used to help boost an economy in the wake of a recession, though, as can be seen from both the TRA of 1986 and the Bush Tax Cuts Act. Time will tell if the TCJA will make a lasting, long-term effect on GDP growth. That said, the results from this study have been accounted for and it has been determined what areas of the tax system should be targeted for the next tax reform to make a lasting positive impact on the economy.

6. *Recommendations*

The three most recent tax policy changes have given a solid basis on why they were passed, the economic effects of such changes, and how each entity or income group is affected. The main goal of the IRS is to make money for the government. They want to do this in the most efficient way possible to grow the economy at the ideal level. All three policies had some positive results and some policies experienced unintended consequences that were repealed in other tax law changes. In a recommended tax system for the IRS based on the same criterion discussed above, all three tax acts would have tax policies implemented from them. Most importantly, however, the public perspective must be revised to prove the tax cuts will benefit every income group, and not only benefit wealthy individuals. Not only this, the proposed restructured tax system needs to be easy for the public to understand and the public must be educated on the system. As of now, the Gallup estimates over 49% of the public disagrees with the most recent tax changes the TCJA implemented, while only 40% approve of the reform (Newport, 2019). There is an even larger percentage that disapproved when they polled Democrats versus Republicans. In the end, what will make a greater economic impact is whether the

greatest number of people believe they are being fairly taxed because they will have a higher incentive to work. It has been shown through time that simply changing variables within the tax formula does not correlate to higher economic growth alone. There are changes seen in the short run, and even smaller changes when looked at in the long run. There are some changes seen in productivity and other supply-side effects, but these effects are counteracted by fewer federal receipts and less productivity from the income effect. For the future of tax reforms, it is vital to regain the public's trust in the income taxation system. This means to make a system equally beneficial to the low-income earners as they are to the wealthy taxpayers. The trust made will boost productivity in the economy in itself. The way the trust will be gained is by showing evidence of how all Americans will not only reduce their tax liabilities but how they will benefit from a new system. Many opponents of the TCJA said an increase in the growth of the stock market was one of the main goals and benefitted the people who passed the bill. Not only this, but they focused on decreasing taxes for wealthy people, since they are the main people who own stocks. Nonetheless, the majority of Americans have some form of stock, which makes this strategy benefit many Americans. According to The Gallup, in 2019, 55% of Americans owned stock and since 2010, there has been an average of 54% of Americans who own stock (Saad, 2019). It is important to have a tax break for the wealthy since they are the group of people who can make the largest difference in an economy, but the tax reform should be restructure the tax system to make income groups benefit.

In order to do this, the correct tax bracket structure for individual filers is important. The TCJA lowered the marginal rates for all earners, so the structure will be maintained with only two differences. It would benefit the economy to decrease the 22%

tax bracket rate to 20% and raise the top bracket from 37% to 38%. The decrease in the tax to 20% for the filers in the lower-middle income group would not decrease the federal tax receipts to a large degree since the bottom 50% of taxpayers only accounted for 3.1% of total income tax paid, according to the Tax Foundation (York, 2020). What would more than offset the small decrease in tax receipts from this would be the increase for the top tax bracket by just 1%. This tax bracket accounted for 38.5% of the total income taxes collected (York, 2020).

Even though the TCJA raised the standard deduction limit by nearly double, indexing the standard deduction amount to the federal minimum wage at full time would be most fitting. If the standard deduction is set at this limit, people who are living on the poverty line would not need to file a return. This would align with simplifying the tax preparation process for many more individuals and families. To calculate this deduction amount, the current federal minimum wage is $7.25 per hour or $15,080 per year based on a standard 2,080-hour annual workload. When the federal minimum wage changes, the standard deduction will also change. This increase not only makes sense to tax professionals, but it would be clearer to the public and would help lower income families see a tax break to a higher extent than in the past. In a similar light, the personal exemption and the earned income credit will be eliminated. Even though President Reagan thought highly of the earned income tax credit as a way of giving a tax break to impoverished families, this credit is no longer needed. The reason behind this is not to take away tax benefits from the low-income earners, but rather to allow these taxpayers to obtain similar benefits without having to file a return at all. They would no longer need

to pay tax preparer fees and will again simplify their process. The way they will receive similar benefits is through the additional increase in the standard deduction.

The child tax credit will also still be implemented similarly to the TCJA with minor changes. The credit will still be $2,000 but instead of the $200,000 single filer phaseout limit, it will be reduced to $75,000, its pre-TCJA limit. Lastly, the credit will also go back to allowing a full refund of the credit instead of only allowing $1,400. This will further benefit the lower-income filers versus higher-income filers. The child tax credit focuses on benefiting families with children who have lower income by providing tax breaks proportionately by the number of dependents, so it is crucial to make the credit benefit the families that rely on it the most.

The last recommendation from the individual filers' standpoint for tax reform to be successful for long term economic growth is to increase the long-term capital gains rate for filers in the higher marginal rates. Currently, capital gains rates are taxed at 0, 15, or 20% depending on the tax bracket the filer is in. For 2020, the threshold for the 15% tax is $40,001 and the 20% threshold is $441,451. When comparing these rates to ordinary income, these rates are preferential, which is done to incentivize investment. Investment in capital is crucial for long term growth in the economy and the correct tax rate is vital to balance the benefits of investing versus using capital to defer income taxes. This balance can be achieved by having capital gains tax rates lower than ordinary income but still similar. There should be another rate of 25% made up at a threshold of $161,000. Looking back at the TRA of 1986, the capital gains rate was increased to be the same as ordinary income, taxed at 28%. Similarly, the capital rate should be increased to tax wealthy individuals and help avoid tax shelters. Of course, these rates should not

be the same as ordinary income because it would take away the incentive to invest. If a 25% bracket was created at the $161,000 threshold, there would still be preferential tax rates but would merely tax the high-income investors more. The $161,000 came about because filers under this amount of income would have a marginal rate of 24% and filers just above this amount would have a 32% marginal rate.

From the corporation standpoint, the lower flat tax rate is supported by many economists and tax professionals because other developed countries have these lower rates already implemented. This helps the U.S. gain back some foreign income it has lost due to companies reporting overseas because of our high rates in the past, which was another goal of the TCJA but not was specifically discussed in this paper. To keep the incentive for corporations to purchase assets, 100% bonus depreciation shall stay implemented since it has the power to spur the economy in the short term with smaller benefits in the long run. Nevertheless, the decrease in the percentage of allowable depreciation needs to decrease sooner as can be seen from the earlier graph of the significant rise in corporate profits but not an increase in federal tax receipts nor income. By reducing these rates sooner rather than later, there will be a more constant rate of receipts received. As of now, the first-year bonus depreciation schedule is 100% for long term assets in service after September 27, 2017, until January 1, 2023, 80% for long term assets in service in 2023, 60% for long term assets in service in 2024, and so on each year until the year 2026 when bonus depreciation is no longer available. Instead, the process should be sped up to spread out the deductions for a longer period to maintain a more constant income level. For instance, instead of allowing a 100% deduction for 5 years and then reducing it by 20% each year subsequently, the 100% would last for 2 years and

then a 10% decrease each year thereafter until it would end 10 years after implementation. Staying on the topic of depreciation is section 179 immediate expensing. The TRA of 1986 “did not decrease the overall cost of capital for corporations because even though decreased the corporate tax rate from 46 percent to 34 percent, the law lengthened depreciation schedules” (York and Muresianu, 2018). Since the cost of capital increased from this, an increase in private investment did not result. Section 179 immediate expensing is important in conjunction with bonus depreciation to make the cost of capital overall decrease, which will grow private investment and corporate investments. Both of which are a goal for an economy seeking long term growth. With this said, immediate expensing will stay the same as the TCJA has it implemented. The last TCJA change regarding the treatment of business property needed in tax reform is like-kind exchanges. This section will be enacted the same way as it currently is because it provides preferential treatment for property of the same nature but does not provide a tax shelter for all kinds of property.

The new QBI deduction aligns with the reduction in the flat corporate rate and is important to have implemented so no particular entity is vastly more beneficial than the other. Nevertheless, there shall be some amendments to the rules and requirements of the current deduction. First of all, a limitation that should be lifted is the specified service business distinction in deciding the amount of the deduction and if the deduction can be taken. This restriction imposes a penalty on those who use skills as a service to be profitable. The restriction was made to provide tax benefits to the companies that hire employees. While the intention is noteworthy for implementing the restriction, it is difficult in deciding whether a business is a specified service business. Not only this,

even though these companies may be wealthy professionals and may not hire as many employees, the phaseout calculation takes into account a percentage of wages anyway. The businesses that hire more employees will still be rewarded more heavily than those who do not. If not altogether eliminate the specified service distinction, then the phaseout limit should be raised from the current $157,500 for single filers so the deductions limits are less stringent on those taxpayers. The new phaseout limit should be the same as the limit for the other qualified business income companies of $207,500. (2018 dollars). Once this limit is hit, the calculations currently being used for the deductible amount by taking 50% of W-2 wages or the sum of 25% of W-2 wages plus 2.5% of the unadjusted basis of the qualified property will be still implemented. As stated previously, this calculation provides a way for the IRS to favor businesses that hire employees.

Under the proposed tax regulation, the net operating losses will be the same as the TCJA, as it helps prevent a tax shelter of a small corporation to offset gains in other businesses. Dating back from the TRA of 1986, net operating losses have been constantly becoming more restrictive. In 1986, the reform set passive activity rules for losses, so that a passive loss could only be deducted from passive income. In a similar light, the TCJA disallowed taxpayers to carry back a net operating loss. The TCJA also limits the deduction amount to 80% of taxable income in future years. The TCJA also modified the allowable excess business losses as discussed previously. This rule will also be maintained as it aids in preventing tax shelters for wealthy individuals or noncorporate businesses. Lastly, just like all the tax reforms discussed, there will be passive activity rules. This is another way in the past business owners used losses to offset income in other areas. By only allowing these owners to offset passive losses against passive

income and making requirements for what a materially participated owner looks like, another tax shelter loophole is closed.

These recommendations are made on the assumption that other economic factors remain constant for current conditions. These factors include the inflation rate and the monetary policy strategy. The inflation rate has averaged 1.9% since 2017 according to the U.S. Bureau of Labor Statistics. If this rate were to change dramatically, the value of money changes along with many other measurements. For instance, if the inflation rate rose to 10%, the cost of personal consumptions products increases and one must make more money to remain in their current living situation. Tax-bracket creep happens when inflation is higher. Nominal incomes are subject to the higher tax rate but the real income has not changed. Therefore, households end up paying a larger share of real income in taxes. This would mean the tax savings would lose value and become less attractive. Additionally, if the monetary policy strategy were change from its current expansionary phase, the tax cuts would need restructuring. According to the Federal Reserve, its current policy is to sustain strong labor markets and the longest economic expansion the U.S. has seen. The proposed tax cuts align with this strategy through increased incentives to work and an increase in after-tax income to increase spending and savings.

7. *Conclusion*

The tax provisions changed in the last three large tax reforms have affected various stakeholders in different ways. By looking at each reform closely, the study was able to identify how each stakeholder was impacted. The high-income earners have been notorious for benefitting largely from tax cuts in previous tax codes and only time will

tell if this will continue in the future. The economy was also impacted differently surrounding the passing of the tax reforms; however, it was not concluded that the reforms were the reasons behind each economy's performance. Lastly, it is crucial in the future to gain back the public's trust in a taxation system. The recommendations listed make this trust possible going forward and provide a way for the income tax system to promote productivity in the economy.

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