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House GOP Tax Plan Likely to Contain Same Basic Flaws as Earlier Versions of the Plan

Core Features Lead to Plan's Upward Tilt, High Cost, and Harm for Most Americans

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This week, House Republicans are expected to release their tax bill, offering specifics to fill in the tax-plan "framework" that congressional Republican leaders and President Trump released in September.[1] The plan's authors have sharply criticized previous analyses of their framework in the absence of legislative text, claiming that its impact cannot be known without full knowledge of the plan's parameters.[2] The release of bill text should allow more precise estimates of the bill's impact on deficits, different income groups, and economic growth. Yet the major problems with the framework put forward by Republicans in September will remain in any bill they now release. In particular, we expect that any bill will continue to:

- Provide the largest gains to the wealthiest households;
- Offer significant benefits to large corporations, while increasing incentives to shift profits overseas;
- Add substantially to the budget deficit, thereby creating future pressure for cutting programs that primarily benefit low- and moderate-income families; and
- Provide low- and moderate-income families with little if any tax relief, even as they are likely to bear much of the burden of the bill's costs if and when subsequent budget cuts are made to address the increase in deficits that the bill would engender.

[1] U.S. Department of the Treasury, "Unified Framework for Fixing Our Broken Tax Code," September 27, 2017, https://www.treasury.gov/press-center/press-releases/Documents/Tax-Framework.pdf

[2] Senate Committee on Finance, "Hatch Opening Statement at Finance Committee Hearing on International Tax Reform," October 3, 2017, https://www.finance.senate.gov/imo/media/doc/10.3.17%20Hatch%20Opening%20Statement%20at%20Finance%20Committee%20Hearing%20on%20International%20Tax%20Reform.pdf; Emily Schillinger, September 29, 2017, https://twitter.com/ELSchillinger/status/913853036157693952.

These problems will likely remain in the bill released this week, because they are inextricably connected to GOP leaders' basic approach to taxes. The White House and congressional Republican leaders have made clear that they are structuring their plan around large cuts in personal and corporate income tax rates, a big cut in the tax rate for pass-through income (business income claimed on the owner's individual income tax return), and major cuts to the estate tax — and that they are seeking to make the plan fit the narrow procedural requirements of the budget reconciliation process so it can pass the Senate with only Republican votes. Under this approach, it is all but impossible to construct any plan that does not contain the key flaws listed above. Unless Republicans are willing to jettison core elements of their plan, it will remain heavily tilted toward the top. And so long as they proceed with an approach that adds $1.5 trillion to the deficit, their plan will put programs for low- and middle-income people at risk in the future.

Plan Will Still Overwhelmingly Benefit the Wealthy

President Trump, Treasury Secretary Steven Mnuchin, and other drafters of the Republican tax framework have promised that their plan will not provide a tax cut for the wealthy.[3] The framework they released in September comes nowhere near meeting that promise, however, providing 80 percent of its benefits to the top 1 percent of households by 2027 and boosting their incomes by more than 8 percent, according to Tax Policy Center (TPC) estimates.[4] Meanwhile, the bottom 80 percent of the population would get less than 13 percent of the tax cuts, and their after-tax incomes would rise by less than half of one percent, on average.

It is, of course, possible to craft a tax plan that does not benefit the wealthy — but not while maintaining the core components of the September framework, which its drafters have shown no interest in jettisoning. All of these components — setting a new, lower rate for pass-through income, sharply reducing or repealing the estate tax, lowering the top individual income tax rate, eliminating the Alternative Minimum Tax, and deeply cutting corporate taxes — provide windfalls to those at the top of the income scale that the other tax changes on the table are too modest to offset. By maintaining these core elements of their plan, the drafters of the Republican framework all but guarantee that those at the top of the income scale will get a very large tax break.

Changes reportedly under discussion wouldn't alter that basic fact or fix the problems that the changes purportedly would address:

- **Limiting tax avoidance under the new pass-through rate.** TPC estimates that the reduction to 25 percent in the tax rate on pass-through income, as proposed in GOP leaders' tax framework, would cost $770 billion over ten years — with $130 billion of that due to tax avoidance as many high earners reclassify their salaries as pass-through income to take

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[3] Center on Budget and Policy Priorities, "GOP Leadership Tax Plan Violates Mnuchin Rule by Delivering Windfall to High-Income Households," updated October 30, 2017, https://www.cbpp.org/research/federal-tax/trump-campaign-and-house-gop-tax-plans-violate-mnuchin-rule.

[4] TPC Staff, "A Preliminary Analysis of the Unified Framework," Tax Policy Center, September 27, 2017, http://www.taxpolicycenter.org/publications/preliminary-analysis-unified-framework.

advantage of the lower rate.[5] GOP lawmakers have said there will be "guardrails" to prevent this tax avoidance, but tax experts are deeply skeptical that lawmakers can come up with measures that would be effective. Tax experts have good reason for this skepticism: even under current law, high-earning professionals have an incentive to reclassify their salaries and wages as "business" income to avoid payroll taxes, and Congress and the IRS have struggled to stop that avoidance.[6] Under the GOP tax-cut proposal, the reward for such tax avoidance would be *many times larger* than it is today, since the GOP plan would create a huge gap between the top tax rate for pass-through income and the top rate for salary income.

It's worth noting that TPC's analysis of a pass-through tax cut similar to the Republican proposal found that the new pass-through rate would give the top 1 percent of households a $565 billion tax break on their *existing* pass-through income — that is, even before any new tax avoidance activity.

It's also noteworthy that 86 percent of the businesses that produce pass-through income would get *no benefit at all* from this new tax break because they already pay at a top tax rate of 25 percent or lower.[7]

- **Keeping the estate tax in some form**. Instead of fully repealing the estate tax, congressional Republicans are now expected to substantially raise the amount that's exempt from the tax, and possibly to lower the tax rate. Such changes would still only benefit the extremely wealthy. Because the estate tax applies only to estates worth more than $11 million per married couple ($5.5 million per person), 99.8 percent of estates are already entirely exempt from the tax. Any weakening of the tax thus benefits only the estates of the wealthiest 0.2 percent of estates. Moreover, raising the exemption amount would benefit *every* estate now subject to the tax, including the very wealthiest estates.[8]
- **Adding a new top tax bracket.** House Speaker Paul Ryan has indicated that the tax plan will have an additional top rate "designed to make sure that we don't have a big drop in income tax rates for high-income people." The idea is presumably that for the highest earners, the rate will remain at or near the current 39.6 percent. This change would *not*, however, prevent those highest earners from still getting a very large tax cut. The GOP bill may not lower the 39.6 percent rate for these filers, but as long as it retains the other provisions in the Republican tax framework, it still will give tax cuts averaging about $138,000 in 2018 to people who make over $1 million a year, boosting their after-tax incomes by more than 5 percent.[9]

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[5] Center on Budget and Policy Priorities, "Pass-Through Tax Break Would Benefit the Wealthiest and Encourage Tax Avoidance," updated October 4 2017, https://www.cbpp.org/research/federal-tax/pass-through-tax-break-would-benefit-the-wealthiest-and-encourage-tax-avoidance.

[6] For a discussion of attempts to stop avoidance, see Chuck Marr, Chye-Ching Huang, Brandon DeBot, and Guillermo Herrera, "Trump Tax Plan's Pass-Through Tax Break Would Provide Massive Windfall to the Wealthy," CBPP, updated May 22, 2017, https://www.cbpp.org/research/federal-tax/will-new-trump-tax-plan-include-pass-through-tax-break-for-wealthiest.

[7] CBPP, 2017.

[8] Chye-Ching Huang and Chloe Cho, "Ten Facts You Should Know About the Federal Estate Tax," CBPP, updated October 30, 2017, https://www.cbpp.org/research/federal-tax/ten-facts-you-should-know-about-the-federal-estate-tax.

[9] Chuck Marr, Brendan Duke, and Chye-Ching Huang, "Republican Leaders' Tax Plan Would Deliver Large Tax Cuts to the Wealthiest Americans Even If It Doesn't Cut the Top Rate," October 26, 2017, https://www.cbpp.org/research/federal-tax/republican-leaders-tax-plan-would-deliver-large-tax-cuts-to-the-wealthiest.

> There are four main reasons why high-income people would still reap large tax cuts. First, they would benefit from the plan's lower rates for the *other* tax brackets, since all of their income up to the new threshold for the top bracket would be taxed at those lower rates. Second, they would be the biggest beneficiaries of the cut in the tax rate for pass-through income; pass-through income *already* accounts for nearly 30 percent of the income subject to the top rate, according to TPC, and the plan would give high-income filers an incentive to recharacterize more of their income to qualify for the new, low pass-through rate. As a result, *a large share of high earners' income would not be subject to the top bracket rate.* Third, high-income households own significant wealth in the form of corporate investments, so they would benefit from the plan's corporate income tax cuts (see below). Fourth, the most well-off also would benefit from weakening or repealing the estate tax.

Instead of substantially scaling back the tax cuts for high-income households, it appears that the bill may use gimmicks to try to conceal their true cost and their sharp tilt to the top. For example, it has been reported that the bill may encourage (or compel) taxpayers to put more of their retirement contributions into Roth accounts — for which contributions are taxable but withdrawals in retirement are tax free — instead of into traditional 401(k)s, for which contributions are tax free but withdrawals in retirement are taxable.[10] This would shift revenue from future decades into the coming decade, making the bill look less costly over the next ten years. And, because high-income people account for a highly disproportionate share of retirement contributions, this maneuver also will cause the Joint Committee on Taxation's "distribution tables" for the coming ten years to look like high-income households will be required to pay more tax. In other words, a timing shift in *when* these taxes are paid can be made to look like a tax "increase" on high-income filers that helps "offset" some of the bill's big tax cuts for these people, when in reality no such offsetting tax increase would actually occur.[11]

Plan Will Still Provide Large Benefits to Corporations, Plus Incentives to Shift Profits Offshore

The White House and congressional Republican leaders have yet to provide full details on their corporate tax plan, but by centering it on a large rate cut and a shift to a so-called "territorial" system, they have virtually ensured that it will benefit many large, profitable corporations and provide an incentive to shift more profits overseas.

While the bill may include phase-ins and gimmicks to mask its true cost, it will likely give corporations a large net tax cut, with the overwhelming share of the benefits from that tax cut going to shareholders and corporate executives. Estimates from the Congressional Budget Office, the Joint Committee on Taxation, non-political experts at the U.S. Treasury, and non-partisan experts like TPC all assess that roughly a quarter or less of corporate taxes fall on workers. As a result,

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[10] Richard Rubin, Anne Tergesen, and Siobhan Hughes, "House Republicans Are Still Considering 401(k) Changes in Tax Overhaul," *Wall Street Journal*, October 25, 2017, https://www.wsj.com/articles/gop-house-tax-chief-changes-to-401-k-are-still-on-the-table-1508940867; David Kamin, "Beware of Retirement Tax Gimmicks," October 30, 2017, https://medium.com/@kamin_83016/beware-of-retirement-tax-gimmicks-9b26246a70b9.

[11] Kamin, 2017.

workers would receive a quarter or fewer of the benefits of these corporate tax cuts.[12] And even among the workers who do benefit, the gains are likely to be concentrated among high earners.

Overall, more than a third of a corporate rate cut would flow to the top 1 percent of households, and 70 percent to the top fifth, TPC estimates.[13] Likewise, a range of experts have concluded that the Administration's estimates of large wage gains from a corporate tax cut are highly unrealistic. The result is that the Republican plan's corporate tax cuts would provide little benefit for the vast majority of workers, while increasing deficits that ultimately threaten to leave most Americans worse off.

The plan would also *increase* incentives for corporations to shift profits and investments offshore, risking U.S. revenues and U.S. workers' wages. The plan proposes a "territorial tax," which means a very low or zero U.S. tax rate for U.S. companies' *foreign* profits. The House bill, like the GOP tax framework, reportedly will propose to tax *domestic* profits at a 20 percent rate but may propose a minimum tax rate of much *less* than 20 percent for foreign profits. A large, permanent tax advantage for foreign profits would give firms a powerful incentive to shift profits offshore, by using complex tax avoidance techniques to claim that they have earned them in tax haven countries where they would face little or no foreign tax even as they are getting the lower U.S. corporate rate for foreign profits. And it would also be an incentive to shift investments overseas. Moreover, tax experts have pointed out that – perversely -- such a minimum tax could be designed in such a way as to aggravate this tilt and not mitigate it.[14]

Further, tax experts are skeptical that policymakers could craft effective anti-avoidance rules if tax reform created a huge tax discount for foreign profits. Other countries that have adopted territorial tax systems have struggled to address widespread tax avoidance by multinationals booking their profits in tax havens.

Plan Will Likely Add at Least $1.5 trillion to Deficits, Setting Stage for Future Budget Cuts

The congressional budget resolution specifies that the tax bill can add up to $1.5 trillion to the deficit over the next ten years.[15] Reports indicate that Republican leaders are struggling to reduce the cost of their bill to fit within that limit; a TPC estimate of the September tax framework — which assumed that Republicans would scale back deductions to a greater extent than now seems likely — projected a cost of $2.4 trillion for the plan.

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[12] Chye-Ching Huang and Brandon DeBot, "Corporate Tax Cuts Skew to Shareholders and CEOs, Not Workers as Administration Claims," CBPP, August 16, 2017, https://www.cbpp.org/research/federal-tax/corporate-tax-cuts-skew-to-shareholders-and-ceos-not-workers-as-administration.

[13] *Ibid.*

[14] Vidya Kauri, "Federal Coffers Vulnerable Under Global Minimum Tax Plan," Law360, October 23, 2017, https://www.law360.com/articles/976616/federal-coffers-vulnerable-under-global-minimum-tax-plan.

[15] Robert Greenstein, "Commentary: Congressional Budget Plan a Major Step Toward Costly, Ill-Advised Tax Cuts," CBPP, October 26, 2017, https://www.cbpp.org/federal-tax/commentary-congressional-budget-plan-a-major-step-toward-costly-ill-advised-tax-cuts.

And yet, $1.5 trillion will likely *underestimate* the forthcoming bill's actual cost, since GOP tax-writers are apparently seeking to use various timing maneuvers and gimmicks to help meet that target. Those may include phasing in costly pieces of the bill over a number of years to lower their cost in the initial ten-year period, and having some tax-cut provisions sunset by the end of the ten-year period (with supporters counting on extending them or making them permanent before the tax cuts reach their scheduled expiration date). Such maneuvers are likely to be used to also make it appear as though the bill doesn't increase the deficit *after* the first ten years, which is a requirement for budget reconciliation bills.

Because of these gimmicks, the bill's effective cost will likely far exceed its official cost estimate. That would be consistent with the experience from the Bush tax cuts. As Ways and Means Chairman Bill Thomas stated at the time, the 2001 tax cuts were designed to squeeze "a pound and a half of sugar into a one-pound bag."[16] After the gimmicks — such as phasing in various tax cuts — had faded and the Bush tax cuts were fully in effect (and then, for the most part, made permanent) — the tax cuts' cost reached roughly 2 percent of the economy,[17] substantially more than the initial cost estimate implied.

As noted above, various gimmicks could also make the forthcoming tax package appear less regressive than it actually would be when its provisions were fully in effect.

A large, deficit-increasing tax cut would be even less justifiable today than in 2001. The projected budget surpluses that many lawmakers pointed to that year to justify large, revenue-losing tax cuts don't exist today: deficits have replaced surpluses, and the federal debt as a percent of the economy is expected to grow instead of shrink.

Ballooning the deficit matters. If deficits continually rise faster than the economy grows, they likely will ultimately have adverse economic consequences. Rising deficits will also create pressure to cut programs that primarily benefit low-income and middle-class families. The same congressional budget resolution that lays the groundwork for these tax cuts also calls for $5.8 trillion in budget cuts over the coming decade, including $1.8 trillion in cuts to Medicaid, Medicare, and other health care programs and $800 billion in cuts below the already austere sequestration levels in "non-defense discretionary" programs — the part of the budget that includes education and training, transportation infrastructure, medical research, child and elder care, and the like.[18]

Republican leaders have already indicated that they intend to use future legislation to make such budget cuts, perhaps as soon as a new reconciliation bill next year, and will use deficits to justify doing so. Those cuts could include repealing the Affordable Care Act, cutting Medicaid deeply, and/or cutting key programs that benefit low-income Americans. As *Roll Call* recently reported, it "interviewed half a dozen House Budget Committee members, as well as a few other fiscal hawks in

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[16] CBS News, "Up Next: Death And Marriage," March 16, 2001, https://www.cbsnews.com/news/up-next-death-and-marriage/.

[17] Emily Horton, "The Legacy of the 2001 and 2003 'Bush' Tax Cuts," CBPP, updated October 23, 2017, https://www.cbpp.org/research/federal-tax/the-legacy-of-the-2001-and-2003-bush-tax-cuts.

[18] Greenstein, 2017.

the GOP conference, and they all said they anticipate mandatory spending cuts [i.e., cuts in entitlement programs] being a priority for the fiscal 2019 budget reconciliation process."[19]

Thus, any analysis of the tax plan alone — even one that strips out the plan's gimmicks — will understate how regressive the plan's impact is likely to be over the long run. Ultimately, the cost of the high-income tax cuts is likely to be borne in substantial part by low- and middle-income families through cuts in programs that serve them.

Plan Expected to Provide Little or Nothing for Millions of Working Families

The tax bill is unlikely to provide significant benefit to millions of working families. The major components of the legislation that are meant to benefit low- and moderate-income families are largely offset by other elements of the plan.

Specifically, Republicans have proposed increasing the Child Tax Credit (CTC) and doubling the standard deduction — but also eliminating personal exemptions and increasing the bottom tax rate from 10 percent to 12 percent. For many taxpayers, these changes would mostly cancel each other out: TPC estimates that by 2027, low- and moderate-income families with children would, on average, receive little or no tax cuts, and many could face tax increases.[20] Families that now itemize their deductions could be at particular risk of a tax increase, as they would benefit less from the doubled standard deduction.

Moreover, so long as Republicans' proposed CTC increase is not refundable, it will leave out millions of low-wage working families. Under the proposal in the GOP's September tax framework, working families who have incomes too low to owe federal income tax but still pay payroll taxes and state and local taxes would receive no benefit from the CTC proposal, which would exclude at least 16 million children in these families.[21] Further, the House Budget Committee has suggested that the tax legislation include damaging cuts to both the CTC and the Earned Income Tax Credit that would hurt millions of honest, eligible filers, and children in low-income working families.[22]

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[19] Lindsey McPherson, "On Debt Reduction, GOP Says Wait Till Next Year," *Roll Call*, October 26, 2017, https://www.rollcall.com/news/politics/on-debt-reduction-republicans-say-wait-till-next-year

[20] In areas where the Republican framework did not provide details — such as the income levels at which the different tax rates would kick in — TPC's analysis assumed the plan would match the House GOP's 2016 "Better Way" plan. Yet, even if those details change in the House GOP bill released this week, the fact that millions of low- and moderate-income children would receive little or no tax cut is likely to remain the same, if the plan's overall infrastructure remains similar. For further discussion, see Chuck Marr, "Republican Leaders' Tax Framework Provides Windfall to High-Income Households, With Working Families Largely an Afterthought," CBPP, October 2, 2017, https://www.cbpp.org/research/federal-tax/republican-leaders-tax-framework-provides-windfall-to-high-income-households.

[21] Robert Greenstein *et al.*, "Child Tax Credit Increases in GOP Tax Plan Exclude Millions of Children in Low-Income Working Families," CBPP, October 25, 2017, https://www.cbpp.org/research/federal-tax/child-tax-credit-increases-in-gop-tax-plan-exclude-millions-of-children-in-low.

[22] For details see Robert Greenstein, "Misguided Child Tax Credit Measure Would Hurt 1 Million Low-Income Children," CBPP, updated October 9, 2017, https://www.cbpp.org/blog/misguided-child-tax-credit-measure-would-hurt-1-million-low-income-children, and Robert Greenstein and John Wancheck, "Verifying Incomes of All EITC Filers Would Delay Refunds, Raise Costs, Divert IRS Resources from More Effective Uses," CBPP, September 29, 2017,

Even if the plan were modified to do more for lower- and moderate-income working families, it would still be heavily skewed toward the top, given both the magnitude of the tax benefits for the wealthy and the likelihood of eventual budget cuts (to address the swollen deficits the tax cuts would cause) that would affect people farther down the income distribution. For many low- and moderate-income families, the budget cuts would likely outweigh any potential tax cuts.[23]

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https://www.cbpp.org/research/federal-tax/verifying-incomes-of-all-eitc-filers-would-delay-refunds-raise-costs-divert-irs.

[23] Greenstein *et al.*, 2017, and Center on Budget and Policy Priorities, "Republican Plans to Cut Taxes Now, Cut Programs Later Would Leave Most Children Worse Off," October 18, 2017, https://www.cbpp.org/research/federal-budget/republican-plans-to-cut-taxes-now-cut-programs-later-would-leave-most-0.

SALT "Compromise": Similar Harm to States as Full Repeal

The tax bill that House Ways and Means Committee Chairman Kevin Brady plans to release tomorrow will reportedly end the federal deduction for state and local income and sales taxes, but keep it for state and local property taxes. This "compromise" on state and local tax (SALT) deductions — to pay for marginal income tax rate cuts — would be a bad deal for most Americans, as would a full repeal. It likely would harm state budgets nearly as much in the coming years as full repeal, would likely shift more of the load for paying state and local taxes from high-income people to low- and middle-income families, and would fall much harder on some states than others — while probably hurting local government budgets over time, too.

Property taxes are almost all levied by local governments and aren't a major source of revenue for states, while income and general sales taxes are the two main sources of state tax revenue. Property taxes account for only 2 percent of state tax revenue nationally, while income and sales taxes account for 37 percent and 31 percent, respectively. So for state budgets, which fund education, health care, transportation, and other services, it's the deduction for income and sales taxes, which the House tax bill reportedly would end, that really matters. (Currently, taxpayers can deduct either their state and local income taxes or their state and local general sales taxes, whichever are higher. In all 42 states with an income tax, many more filers deduct their income taxes than sales taxes.) As we've explained, the deduction makes higher-income filers more willing to support state taxes, because they can reduce the federal taxes that they owe by deducting these state taxes. Repealing the deduction would make it harder for states — many of which already face serious budget strains — to raise sufficient revenues in the coming years to invest in high-quality education, infrastructure, and other priorities crucial to the nation's long-term economic prospects.

Repealing the income tax deduction would be particularly harmful to state budgets because state income tax revenues tend to grow with the economy, while other major state revenue sources such as sales and excise taxes do not. By reducing support for state income taxes, particularly among high-income taxpayers — a group that tends to be politically influential in states — eliminating the deduction would encourage states to lean more heavily on weaker revenue sources, likely leading to cuts over time in funding for education and other public priorities. Also, state borrowing costs could rise as bond rating agencies react to states' reduced capacity to generate adequate revenue, raising the cost of needed infrastructure projects.

Further, eliminating the income tax deduction would, over time, likely lead to a shift in who pays state and local taxes even further away from high-income residents to those with middle and lower incomes. That's because state income taxes are the only major state and local revenue source that's based on ability to pay, with tax rates in most states rising with income.

States with income taxes and high average incomes would be the hardest hit. They include Maryland, Connecticut, New Jersey, Massachusetts, Virginia, and Oregon, where more than a third of filers claim the deduction, as well as California and New York, where taxpayers in 2015 deducted $80 billion and $52 billion in state and local income tax payments, respectively. But states without income taxes would also be affected. In Chairman Brady's home state of Texas, which lacks an income tax, over 2 million households — 18 percent of all filers — deducted about $4.8 billion in state and local sales taxes in 2015. They could no longer do so under the "compromise."

Retaining the property tax deduction might protect local governments from added budget pressures to some extent, but only temporarily. First, if they can't deduct state and local income taxes, some taxpayers would no longer be able to itemize their deductions and, therefore, wouldn't be able to deduct their property taxes. Second, facing greater challenges raising revenue, states likely would *shift costs* to *localities* over time, forcing localities to accept less funding for schools, parks, libraries, community health centers, and other services, or to raise local taxes, including property taxes, to make up the difference.

To be sure, eliminating either the full SALT deduction or just the deduction for state and local income taxes would — by itself — make the federal income tax more progressive. But that ignores the actual tradeoff that the House GOP tax plan proposes, which is to end the deduction and use the revenue to pay for marginal income-tax rate cuts, which are more tilted to the top than the SALT deduction. Middle- and low-income people would see little benefit from the overall tax plan, but they would bear the brunt of the harm that's likely done at the state and local levels. That's a bad deal for most Americans.