

Tax Policy in the Age of Trump (and Beyond)

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April 18, 2018

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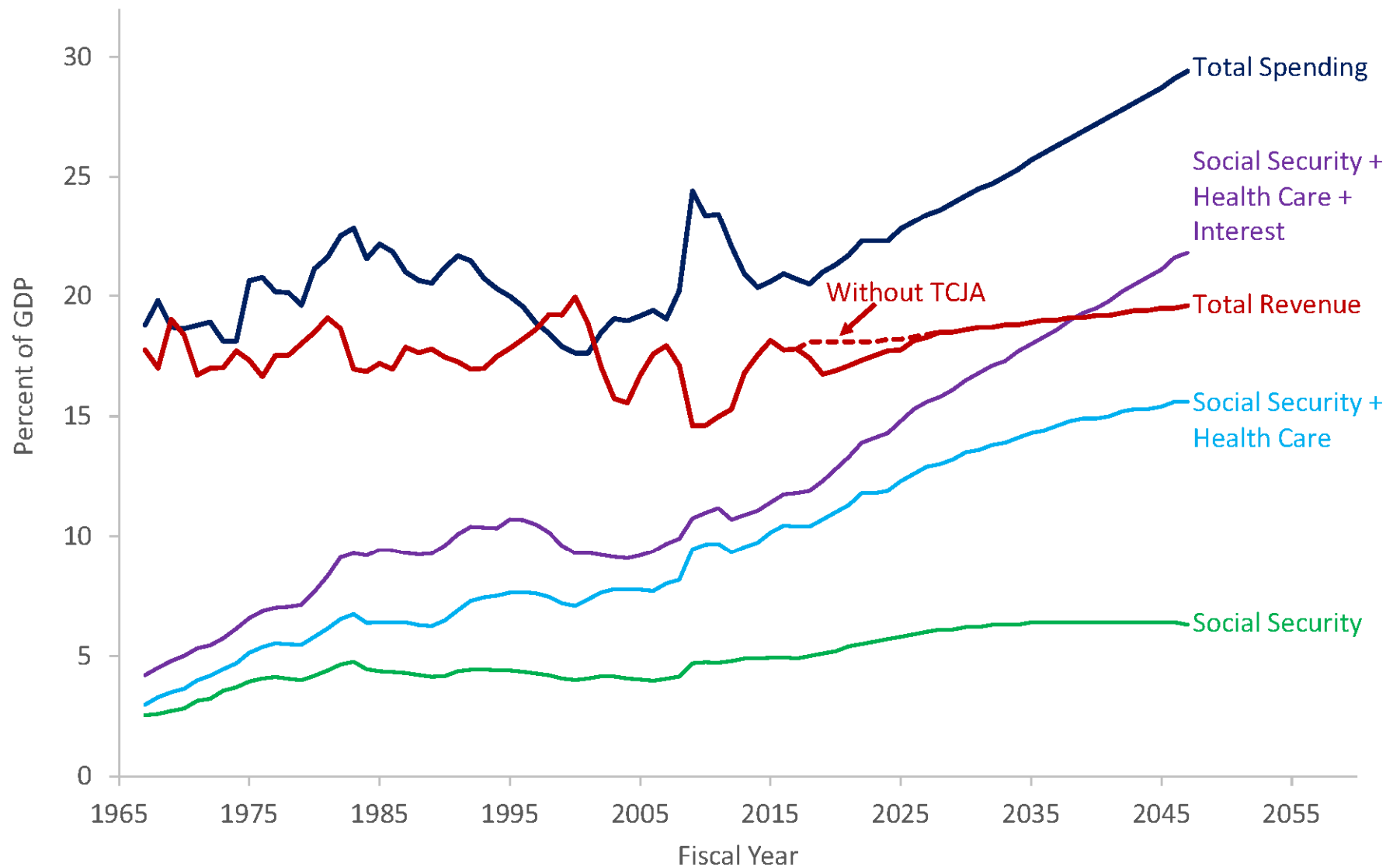
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Criteria for evaluating tax policy

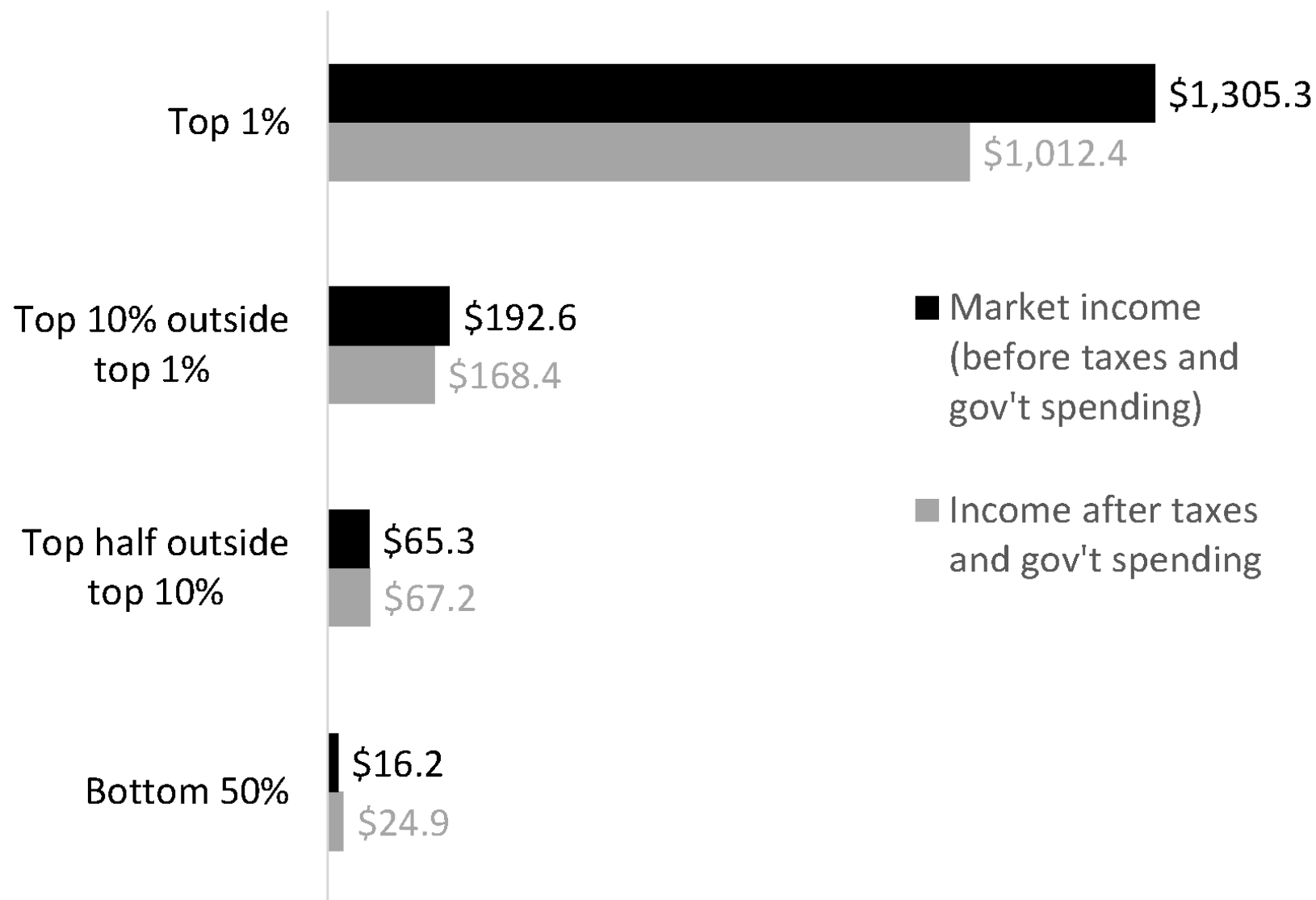
- Equity / fairness / justice
- Economic efficiency and prosperity
- Simplicity / administrative and compliance costs
- Enforceability

US Federal Government Spending and Revenue as a Percentage of GDP, 1967 - 2047



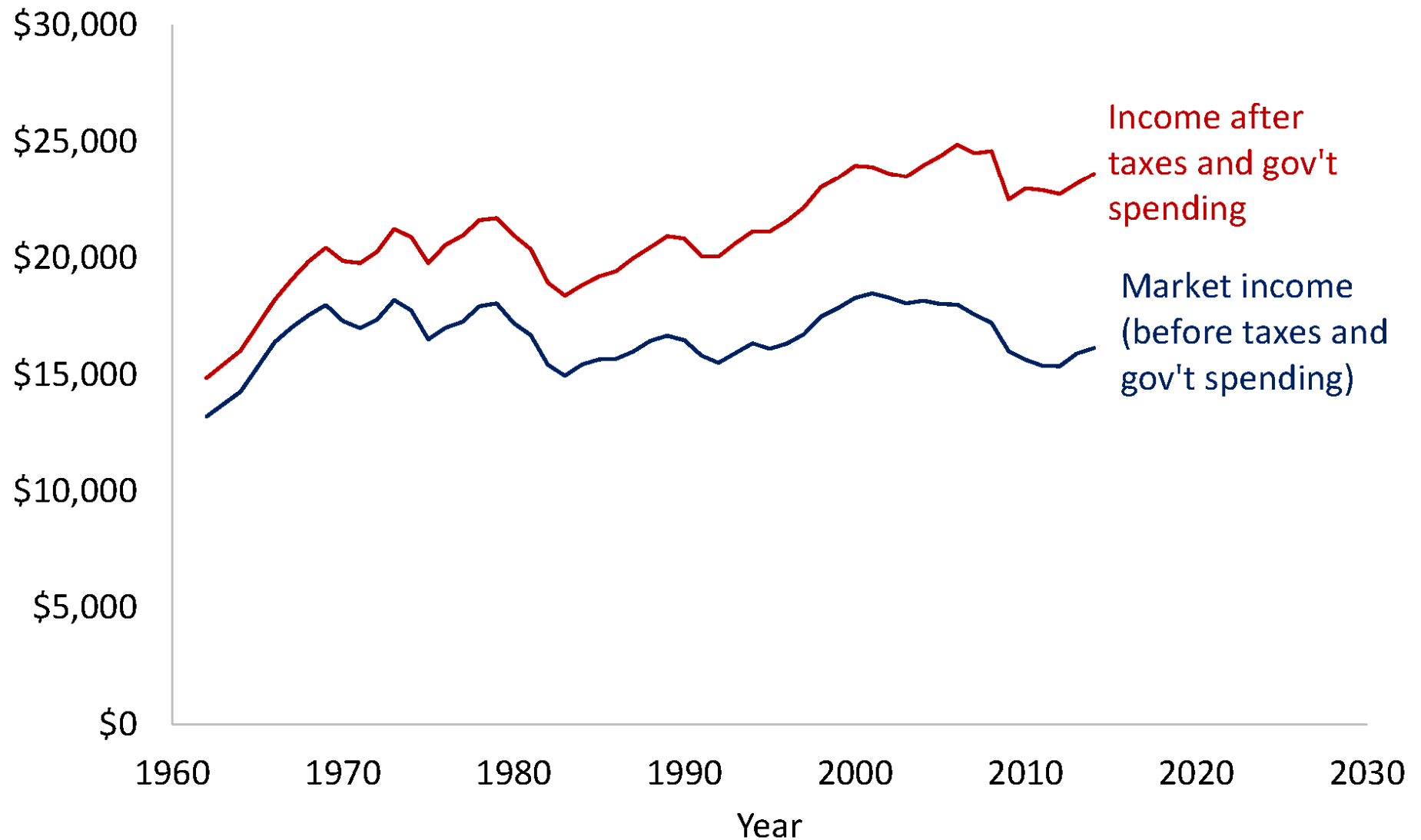
Source: author's calculations based on data from Congressional Budget Office (March 2017) <<https://www.cbo.gov/publication/52480>> and Joint Committee on Taxation (December 2017) <https://www.jct.gov/publications.html?func=download&id=5053&chk=5053&no_html=1> The "TCJA" is the "Tax Cuts and Jobs Act of 2017," the major tax reform that was enacted in December 2017.

Average income per adult in the US, before and after taxes and government spending, in thousands of dollars, by position in income distribution, 2014



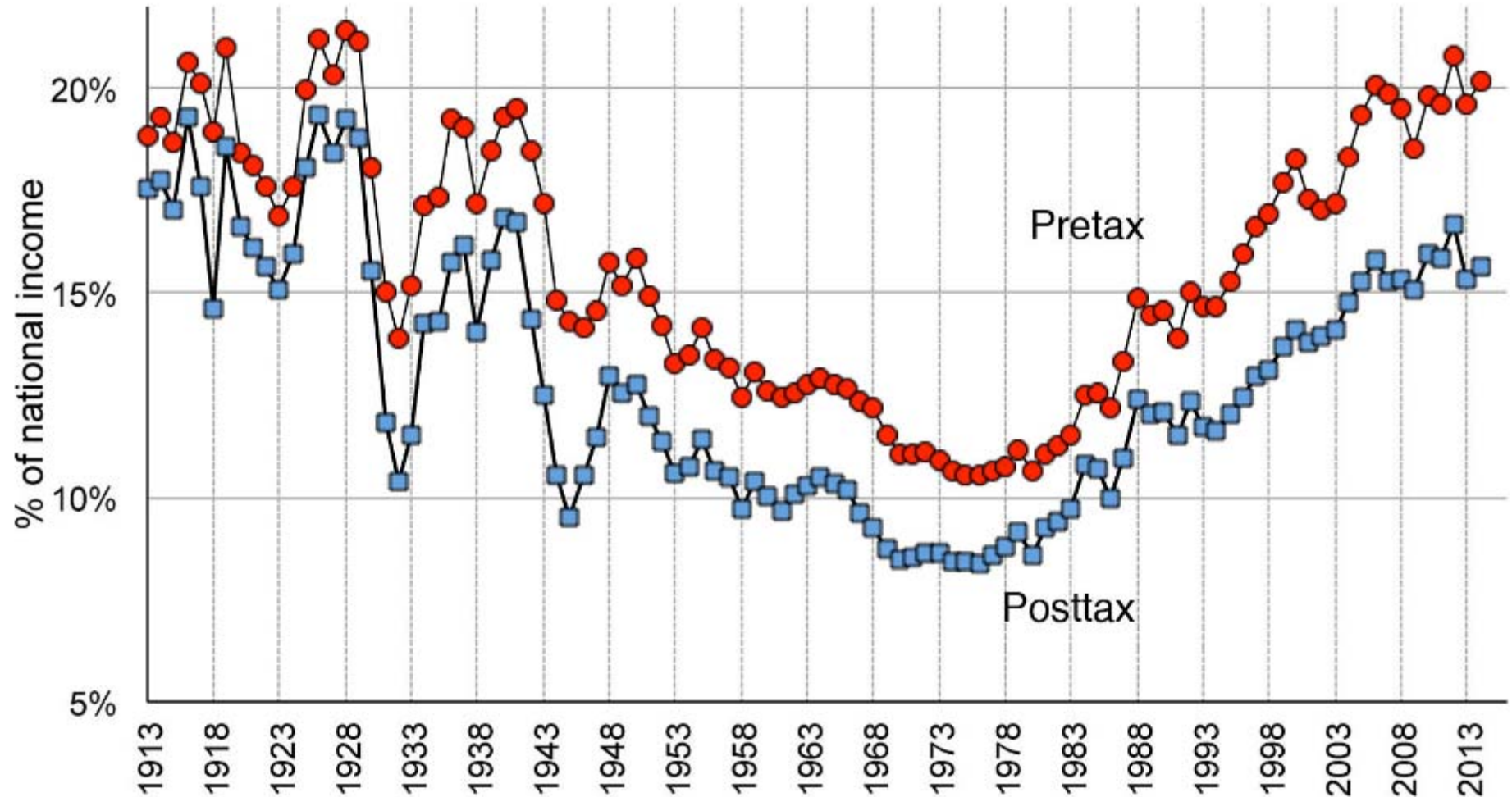
Source: author's calculations based on Piketty, Saez, and Zucman (2018) <<http://gabriel-zucman.eu/usdina/>>

Average income per working-age adult in the bottom half of the income distribution in the US, before and after taxes and government spending, 1962-2014



Source: author's calculations based on Piketty, Saez, and Zucman (2018) <<http://gabriel-zucman.eu/usdina/>>

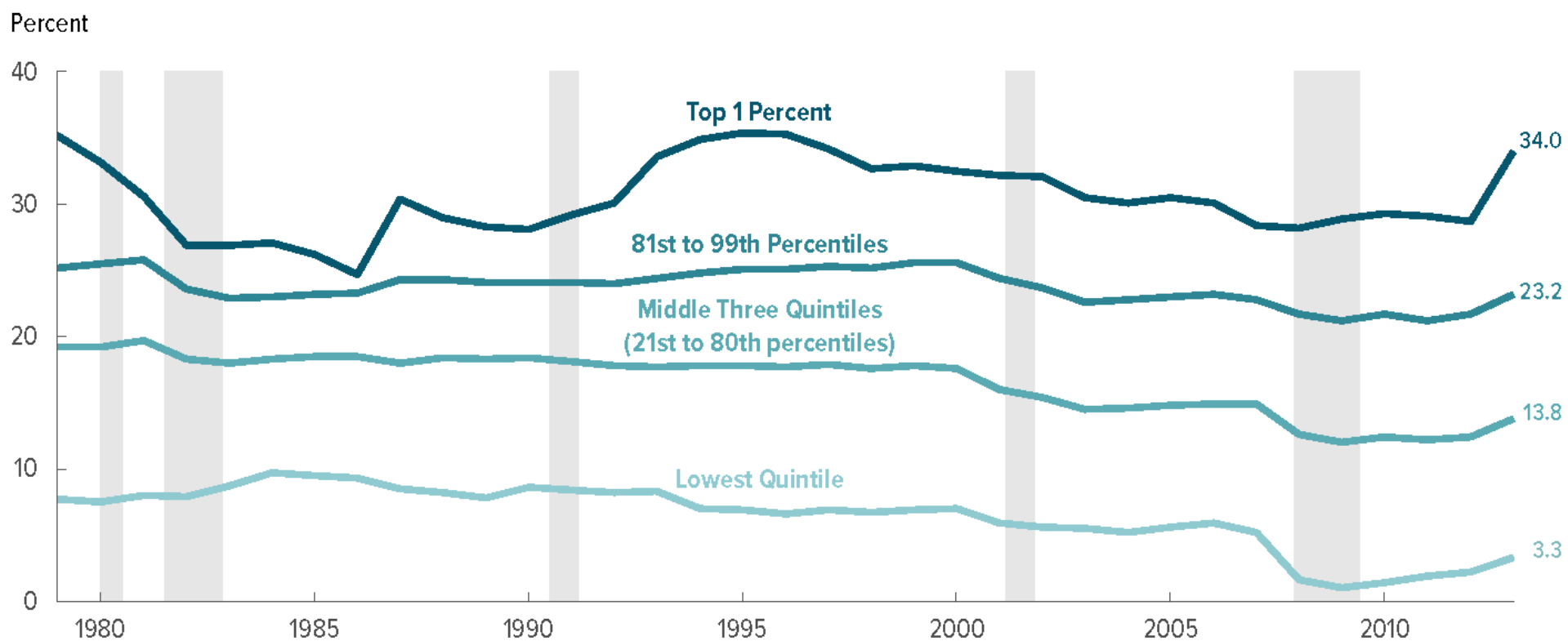
Top 1% national income share: pretax vs. posttax



Note: "pretax" represents market income before taxes and government spending, and "posttax" represents income after taxes and government spending.

Source: Piketty, Saez, and Zucman (2018) <<http://gabriel-zucman.eu/usdina/>>

Average Federal Tax Rates, by Before-Tax Income Group, 1979 to 2013

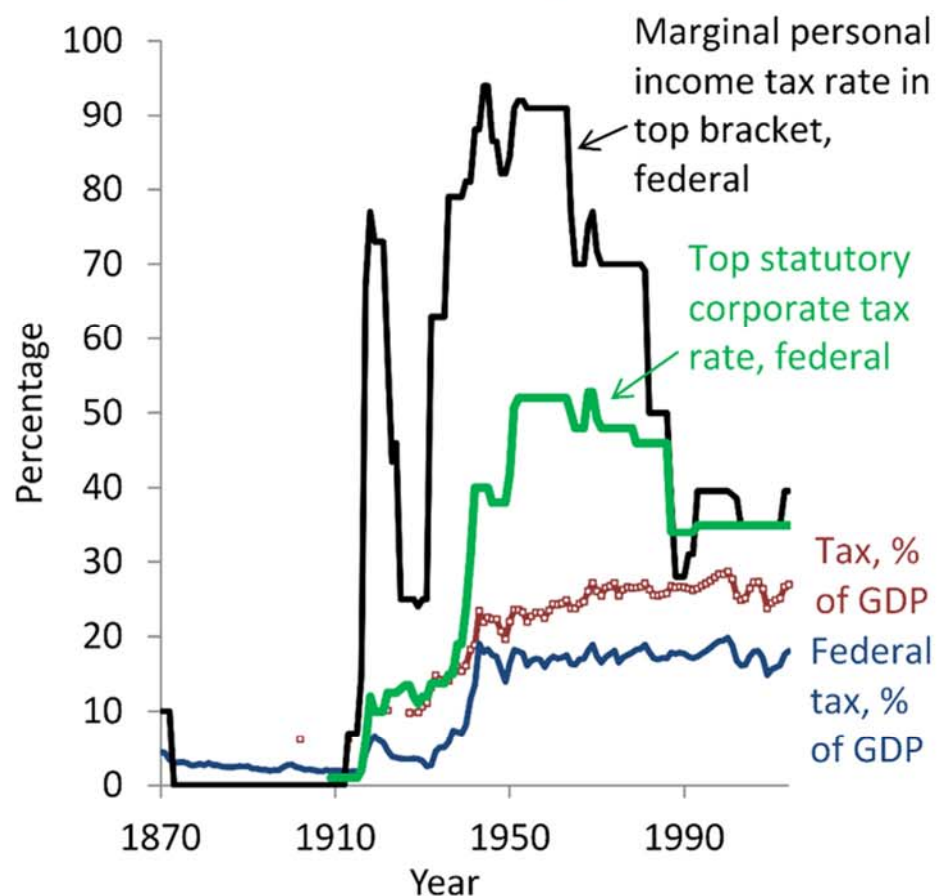


Source: Congressional Budget Office.

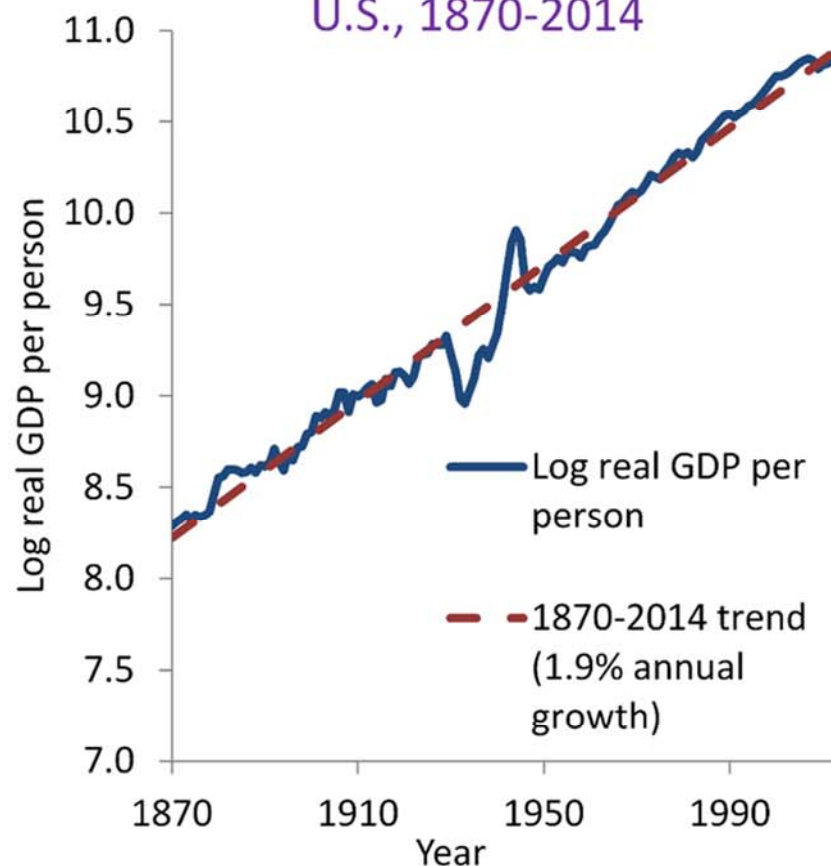
<https://www.cbo.gov/publication/51361>

Over the long-run of history in the U.S., tax rates have experienced large persistent changes, but growth rates of real GDP per person have not

Tax rates in the U.S., 1870-2014



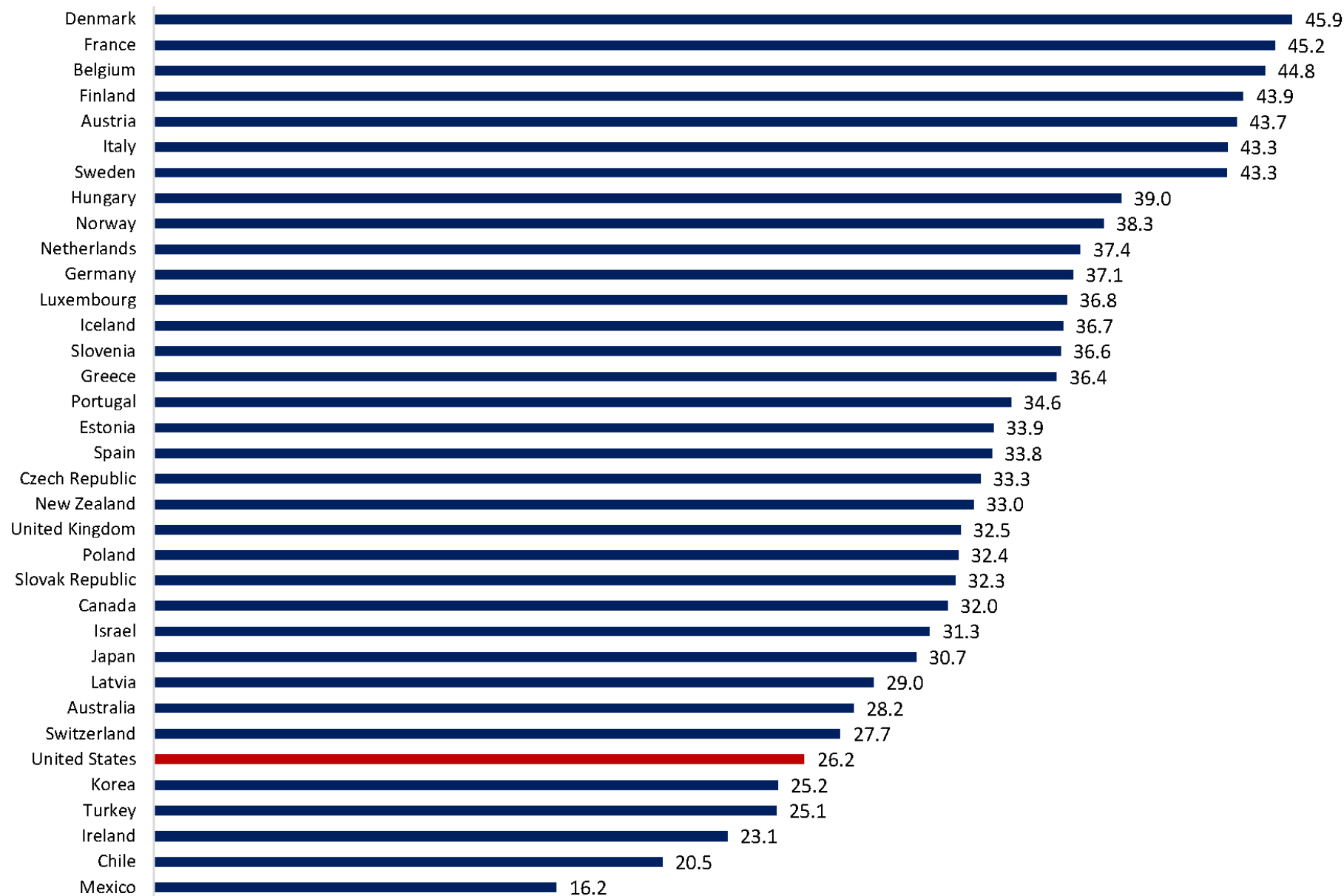
Log of real GDP per person in the U.S., 1870-2014



Sources: authors' calculations based on data from the Maddison Project (2013) and Bolt and van Zanden (2014), U.S. Bureau of Economic Analysis (2015), Carter *et al.* (2006), Internal Revenue Service (2013a), Joint Committee on Taxation (2013b, 2014).

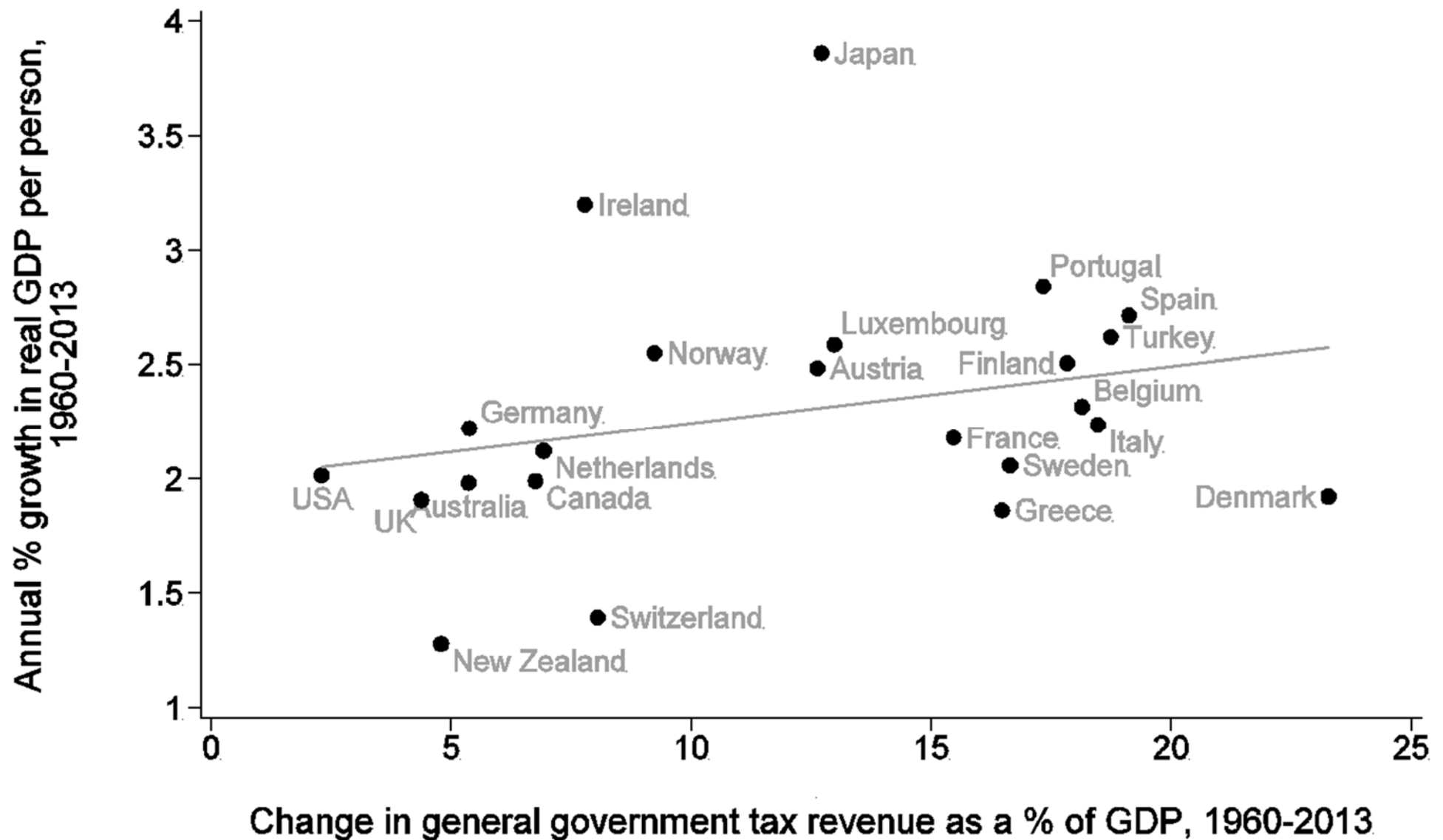
Notes: Real GDP per person is measured in constant year 2014 dollars. Trend in right panel is estimated by regression.

General Government Tax Revenue as a Percentage of GDP in OECD Countries, 2015



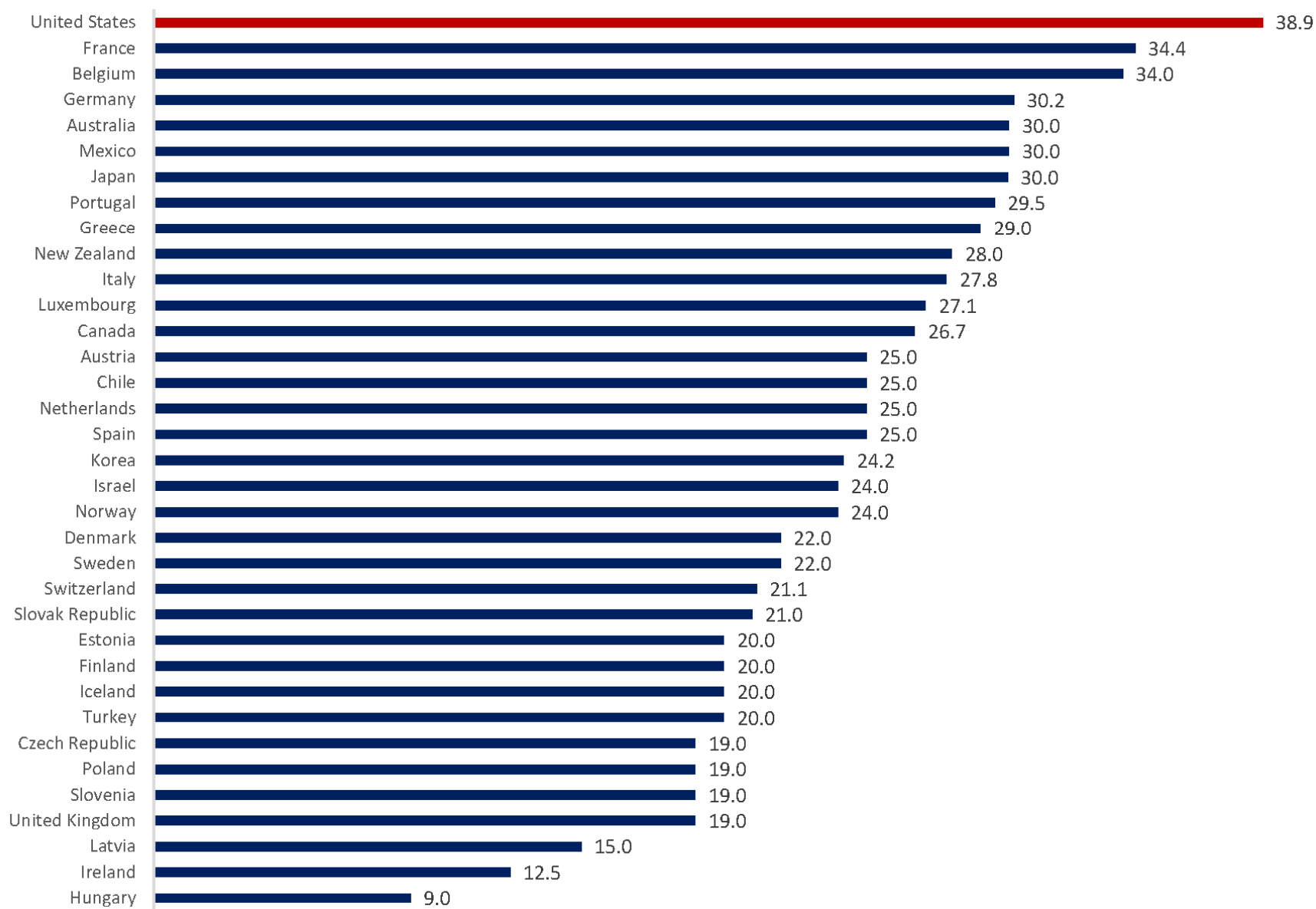
Source: OECD <<https://stats.oecd.org/Index.aspx?DataSetCode=REV>>

Growth in real GDP per person versus change in general government tax revenue as a percentage of GDP across industrialized nations, 1960-2013



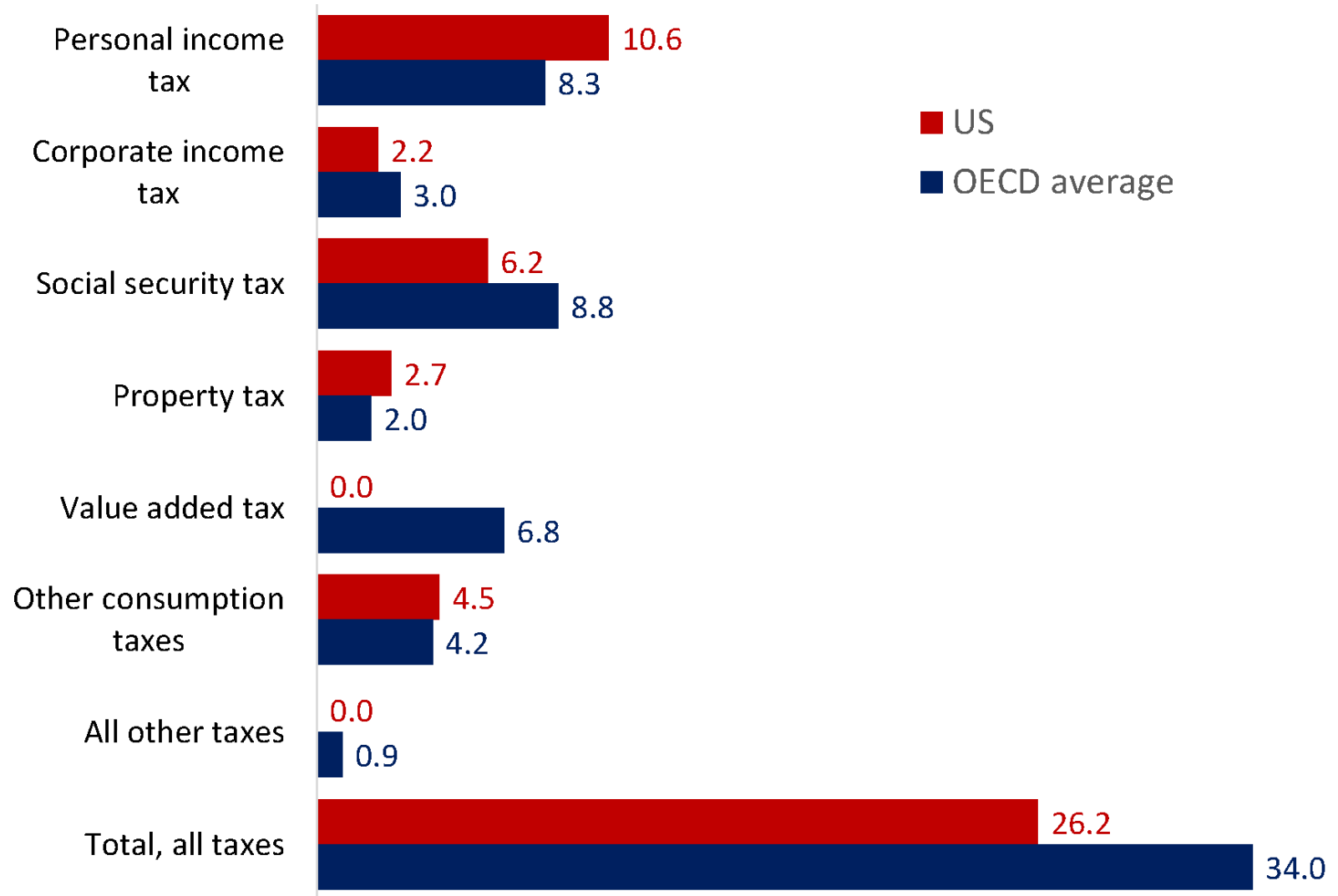
Source: Bakija (2016) <<http://www.jstor.org/stable/10.1525/j.ctt1bpmb6b>>

Statutory Corporate Income Tax Rate (Central Government Rate + Average Subnational Government Rate) in OECD Countries, 2017



Source: OECD <<https://stats.oecd.org/Index.aspx?DataSetCode=REV>>

General Government Tax Revenues as a % of GDP by Type of Tax,
US Compared to OECD Average, 2015



Source: OECD <<https://stats.oecd.org/Index.aspx?DataSetCode=REV>>

Tax classification of businesses in the United States

Tax classification of businesses	Subject to corporate income tax?	Pass-through entity?	Key restrictions	Percentage of businesses, 2012	Percentage of business income, 2012
Sole proprietorship	No	Yes	Owned by individual or married couple	73	11
Partnership	No	Yes	Not publicly traded (with exceptions)	10	30
S corporation	No	Yes	No more than 100 owners	12	18
C corporation	Yes	No	None	5	40

Sources : authors' calculations based on data from IRS Statistics of Income *Tax Stats* website <<http://www.irs.gov/taxstats/>>.

Notes : Includes both non-farm and farm sole proprietorships. LLCs are included in the categories they choose for tax purposes (usually partnership). Excludes real estate investment trusts and regulated investment companies. Last column is calculated based on net income (less deficit) reported to the IRS.

Source: Slemrod and Bakija (2017). <<http://mitpress.mit.edu/books/taxing-ourselves-fifth-edition>>

Business-level marginal effective tax rates on investment in the US before the TCJA varied greatly by type of investment

The business-level federal effective marginal tax rate on capital in the United States

The tax rate is calculated separately for each combination of business type (rows), asset type (rows), and financing arrangement (columns)

	With bonus depreciation			Without bonus depreciation		
	Average financing	Debt-financed	Equity-financed	Average financing	Debt-financed	Equity-financed
Business	8	-54	21	13	-46	24
C Corporation	7	-60	20	12	-51	24
Equipment	0	-71	13	11	-47	23
Structures	13	-49	25	16	-43	28
Inventories	28	-16	37	28	-16	37
Intangibles	-25	-157	-5	-24	-153	-4
Pass-through	10	-44	22	14	-38	25
Equipment	1	-57	13	11	-38	22
Structures	12	-41	23	14	-38	25
Inventories	25	-13	34	25	-13	34
Intangibles	-25	-139	-6	-24	-135	-5

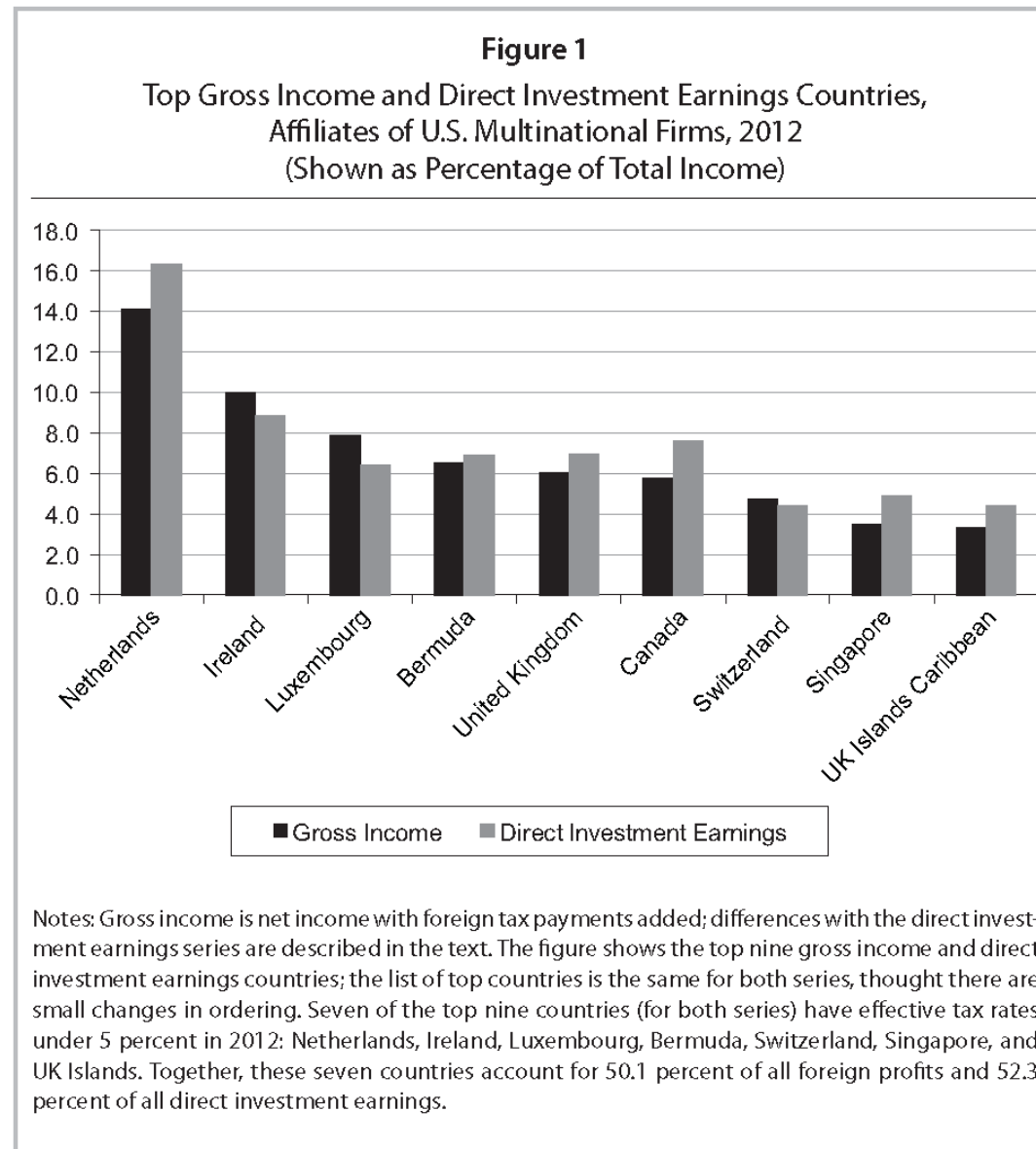
Note: Under current law bonus depreciation expires in 2020. Average financing assumes that 36 percent of the investment is financed by debt and the remainder by equity.

Source: Author's calculations.



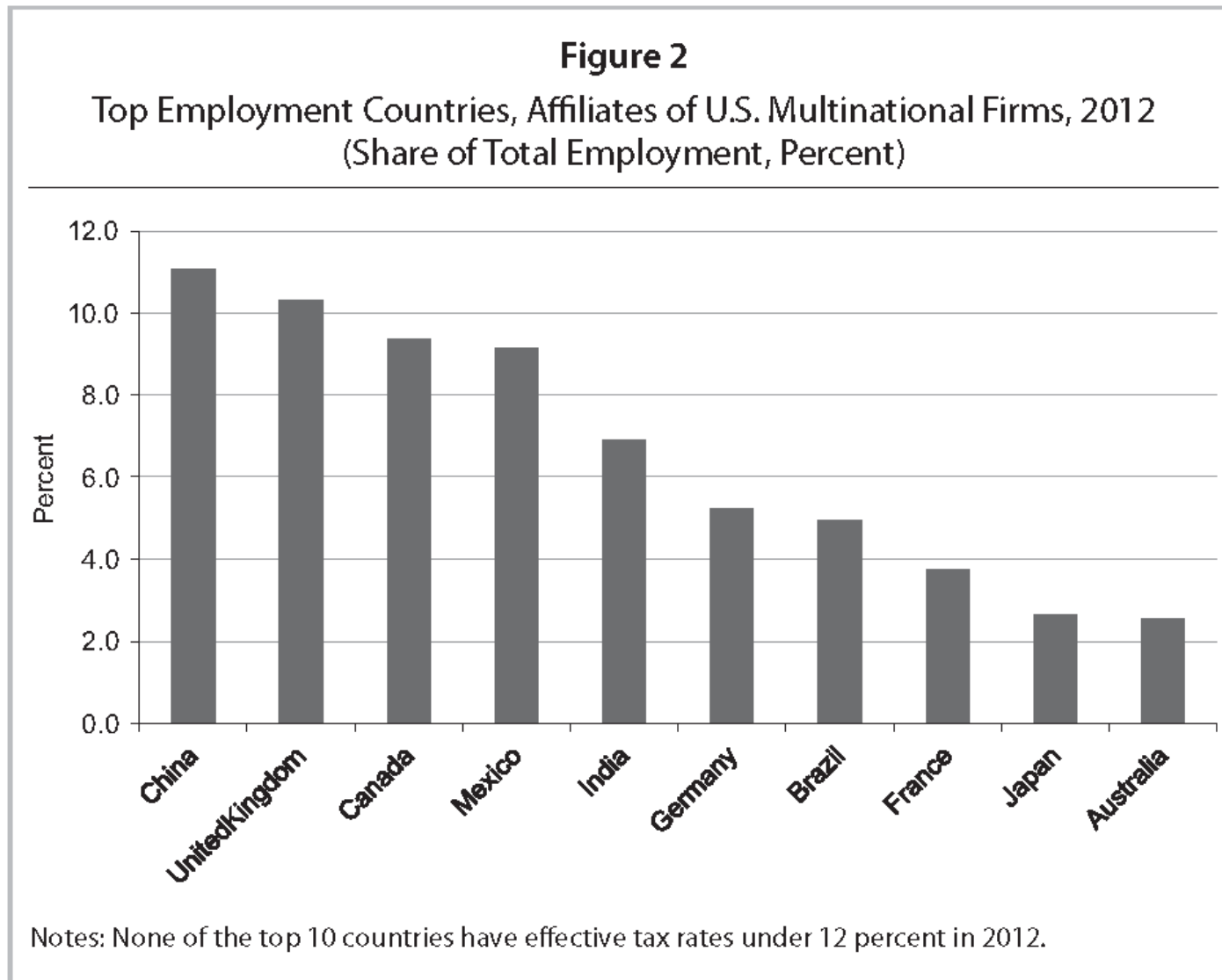
Source: Leiserson (2017) <<http://equitablegrowth.org/research-analysis/what-is-the-federal-business-level-tax-on-capital-in-the-united-states/>>

US multinational corporations claim that more than half of their foreign profits are earned in tax haven countries



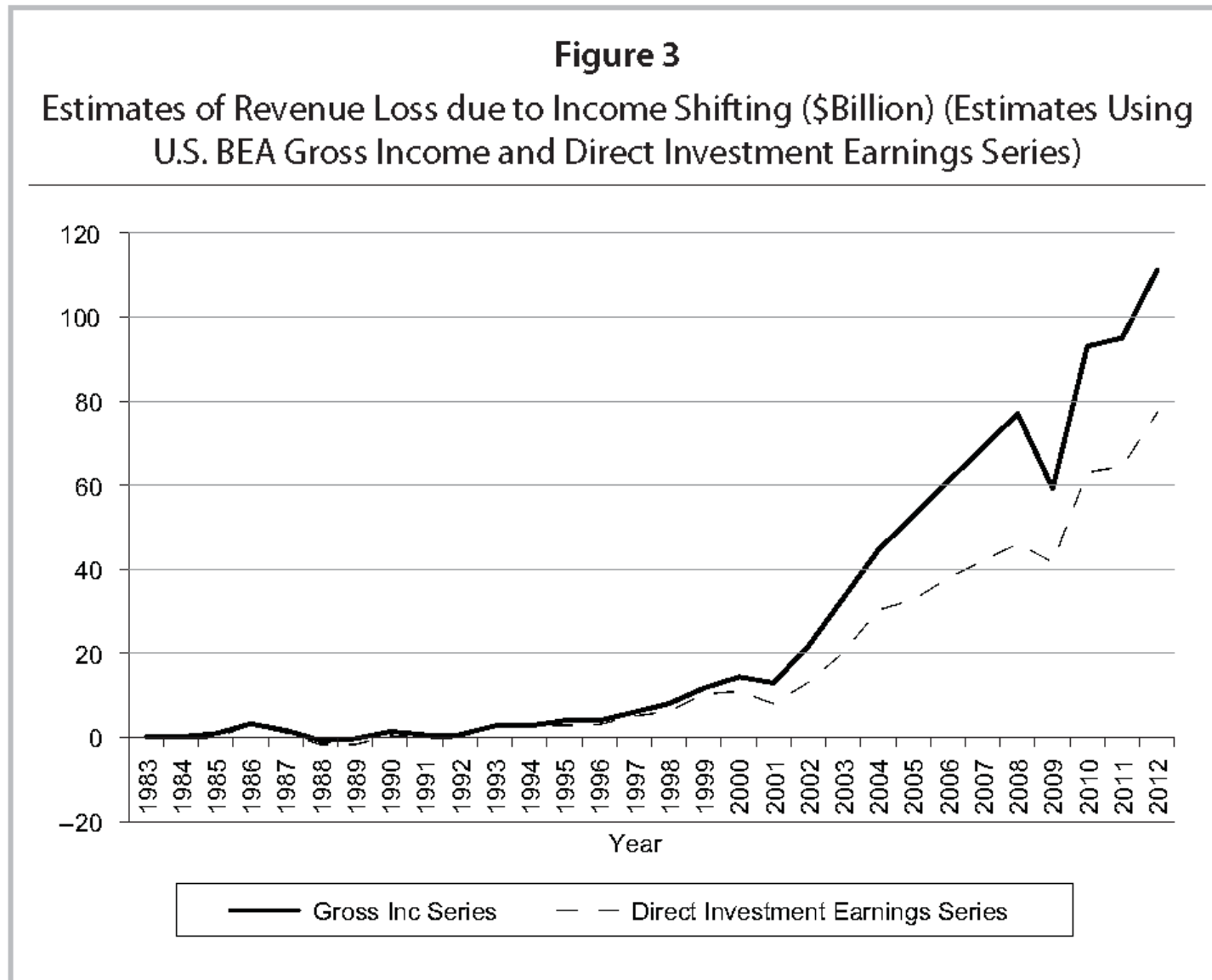
Source: Clausing (2016) <<https://www.ntanet.org/NTJ/69/4/ntj-v69n04p905-934-profit-sharing-effects-corporate-tax-base.pdf>>

Indicators of real economic activity of US multinational corporations such as employment and physical capital are not concentrated in tax haven countries



Source: Clausing (2016) <<https://www.ntanet.org/NTJ/69/4/ntj-v69n04p905-934-profit-sharing-effects-corporate-tax-base.pdf>>.

Recent estimates suggest profit shifting to low-tax countries costs around 30% of US corporate tax revenue, which comes on top of another 16% lost to evasion



Source: Clausing (2016) <<https://www.ntanet.org/NTJ/69/4/ntj-v69n04p905-934-profit-sharing-effects-corporate-tax-base.pdf>>.

Major Business Tax Changes in the Tax Cuts and Jobs Act of 2017 (TCJA)

- Statutory corporate tax rate cut from 35% to 21%
- Major changes to rules for taxing profits of foreign subsidiaries of US multinational corporations
- Temporary increase in depreciation deductions
- Disallows deductions for net interest payments in excess of 30% of adjusted measure of corporate taxable income
- 20% deduction for “pass-through business income” in individual income tax
 - Unlimited if taxable income is below \$157,500 (single) or \$315,000 (couple)
 - Above those income levels, deduction is phased out for certain “personal service” businesses (e.g., doctors, lawyers), unless business pays a enough wages and salaries to other people or has enough property

Tax planning 101

- 1) Buy an appreciating asset, and defer realization (i.e., don't sell it, and don't pay yourself dividends, so no individual tax is owed)
 - 2) Borrow against it to consume, and deduct the interest
 - 3) Die!
- The corporate income tax puts friction in the way of this strategy, serves as a “backstop” to individual taxation
 - Less friction when the corporate rate is well below the top personal rate (now 21% corporate vs. 37% individual)
 - Rate differential creates opportunities to shelter both capital income and labor income in corporations, deferring or eliminating individual tax

Major Individual Income Tax Changes in the TCJA

- Cuts tax rates
 - e.g., top tax rate falls from 39.6% to 37%
- Switches to a measure of inflation that grows more slowly over time for indexing tax law provisions
- Eliminates personal exemption (\$4,150 deduction per person in 2018)
- Doubles child tax credit from \$1,000 to \$2,000
- Almost doubles standard deduction (to \$24,000 for couple and \$12,000 for single)
- Caps itemized deduction for state and local taxes at \$10,000
- Caps mortgage interest deduction to interest on \$750,000 of “new acquisition debt”

TCJA's Changes to Tax Rules for Multinational Corporations

- Eliminates tax on repatriated profits of foreign subsidiaries of US multinational corporations (MNCs)
 - Previously, profits of foreign subsidiaries of US firms were only taxed when repatriated, with credit for foreign corporate tax paid
 - US firms effectively paid difference between US and foreign rate to US
 - But firms could and did defer repatriation, reducing present value of tax payment to US
- Transition tax on accumulated past profits of foreign subsidiaries of US MNCs (15.5% for liquid assets and 8% for non-liquid assets), gradually paid over 8 years.

TCJA's Changes to Tax Rules for Multinational Corporations, continued

- Adds new low tax rate (10.5% to 13.125% depending on the year) on profits of foreign subsidiaries in excess of 10% of foreign tangible capital, with 80% credit for foreign taxes paid
- Reduced tax rate on profits from US exports arising from intangible investments (13.125% to 16.406% tax rate depending on the year)
- Base Erosion Alternative Minimum Tax (BEAT) – complicated minimum tax at low rate (10% to 12.5% depending on year) on a measure of profits that disallows certain deductible payments to foreign subsidiaries in low-tax countries.

Other Notable TCJA Provisions

- Doubles estate tax exemption to \$11.2 million per return
 - Estate tax rate above that amount remains 40%
- 1.4% tax on “net investment income” of colleges and universities with endowments above \$500,000 per student
- Almost all individual tax provisions (except change in inflation indexing) and estate tax provision “sunset” after 2025

Distributional Effects of TCJA Including Repeal of ACA Individual Mandate

TCJA Likely Reduces Welfare for Low-Income Families

Percent change in after-tax income (conventional), 2019, 2025, 2027



Source: Joint Committee on Taxation and Congressional Budget Office.

Note: Excludes changes in the estate tax.

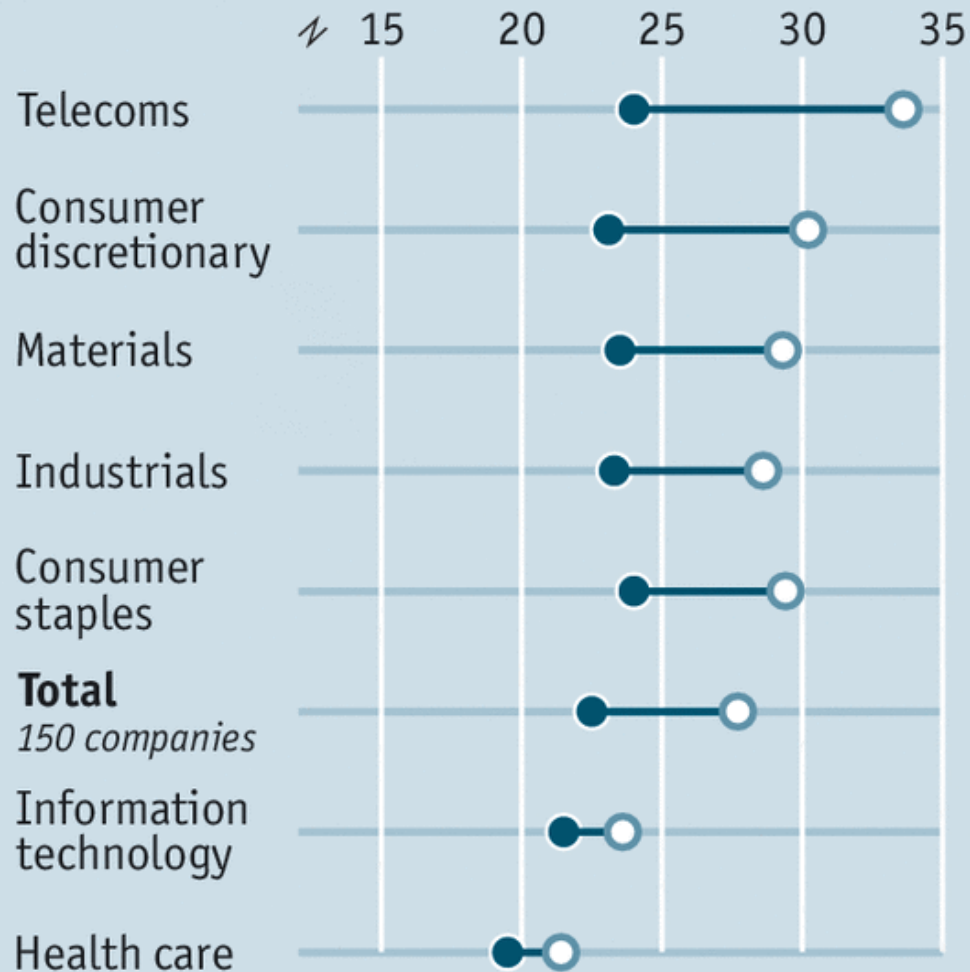


Source: Greg Leiserson <<http://cdn.equitablegrowth.org/wp-content/uploads/2018/02/22153015/US-Inequality-and-Recent-Tax-Changes-Leiserson-FINAL.pdf>>.

Big winners and little winners

United States, effective 2018 corporate-tax rate, %

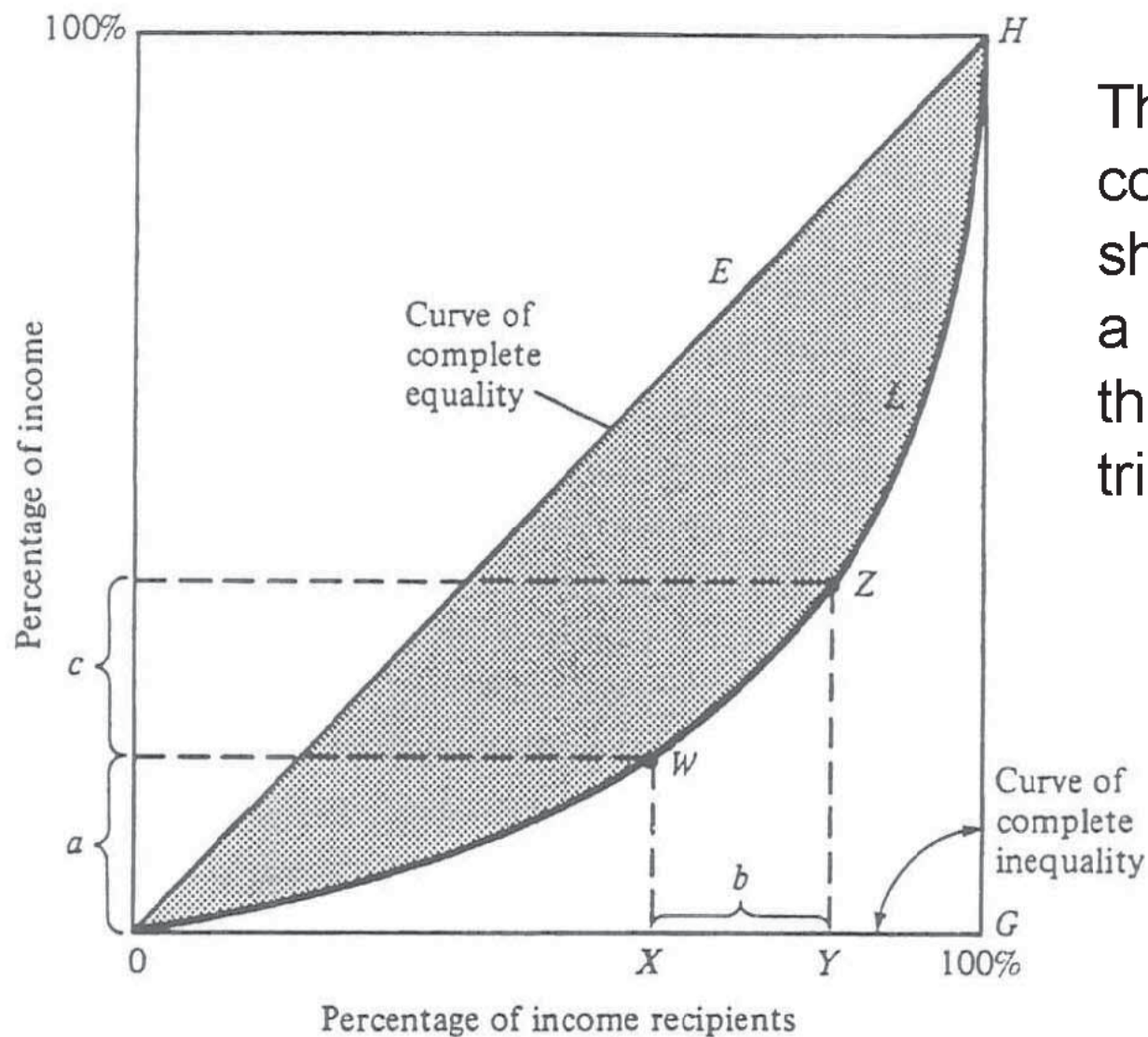
Estimates in: ○ Nov 2017* ● Jan/Feb 2018†



Source: J.P. Morgan

*By brokers
†By companies

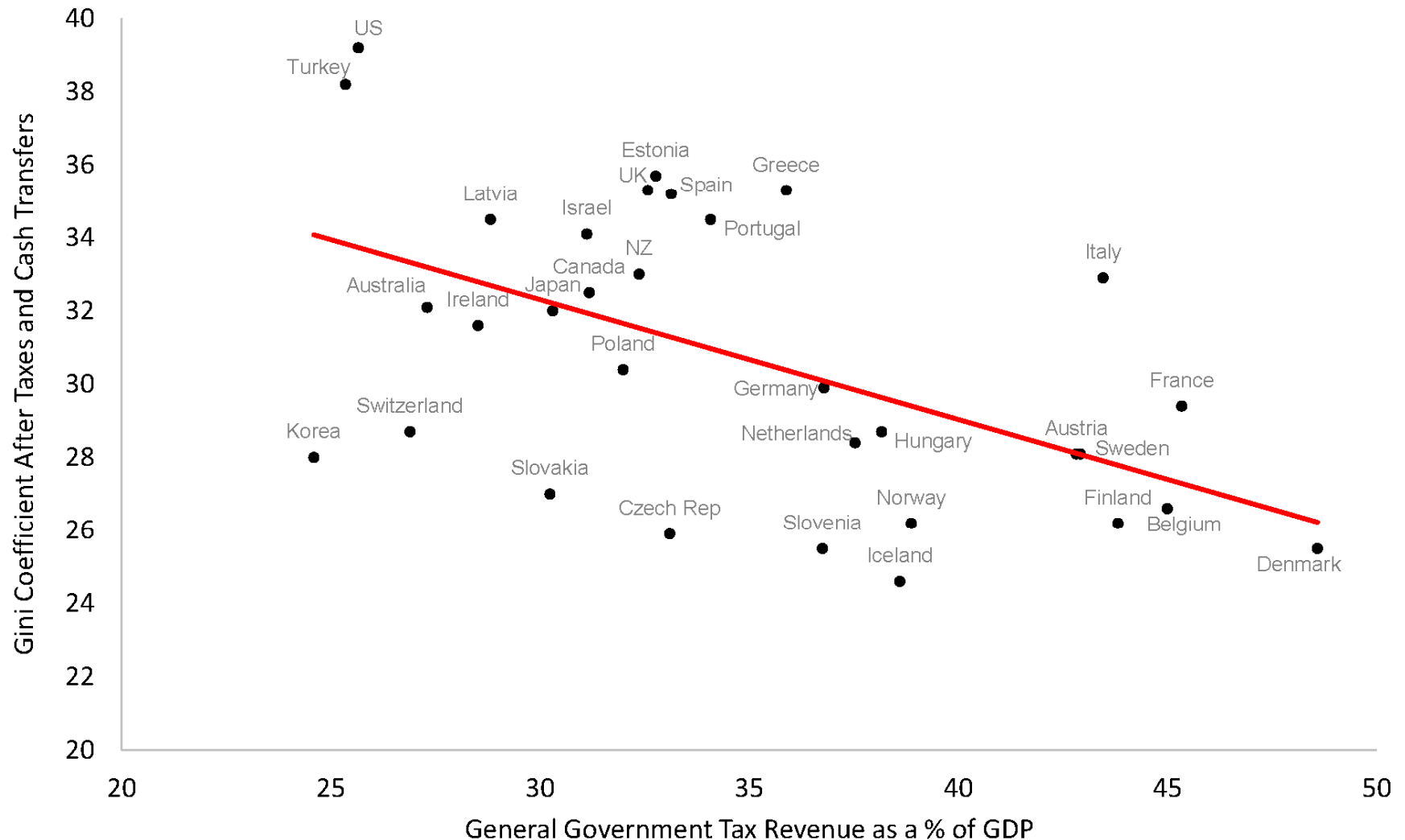
Figure 1. The Lorenz Curve



The Gini coefficient is the shaded area as a percentage of the area of triangle OHG.

Source: Meier, Gerald M., and James E. Rauch. 2005. *Leading Issues in Economic Development*, 8th ed., New York: Oxford University Press.

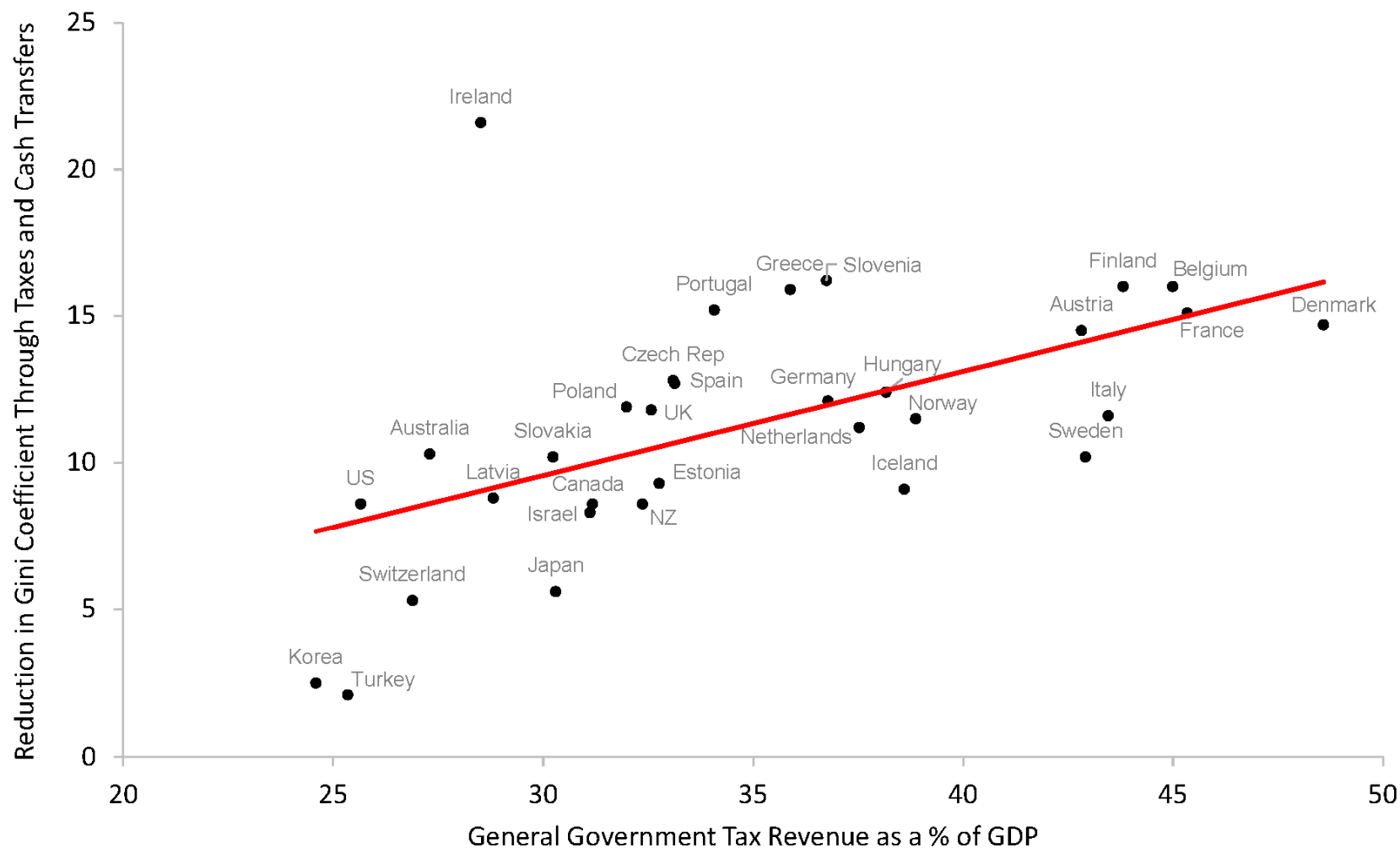
High-Income Countries With Larger Tax Revenue as a % of GDP Have Lower Gini Coefficients (Less Income Inequality) Among Working-Age People After Taxes and Cash Transfers



Note: data are for 2013.

Source: author's calculations based on Lindert (2017) <<https://econpapers.repec.org/paper/tulcegwps/73.htm>> and OECD <<https://stats.oecd.org/Index.aspx?DataSetCode=REV>>.

High-Income Countries With Larger Tax Revenue as a % of GDP Achieve Larger Reduction in Gini Coefficient (Income Inequality) Among Working-Age People Through Taxes and Cash Transfers



Note: data are for 2013.

Source: author's calculations based on Lindert (2017) <<https://econpapers.repec.org/paper/tulceqwps/73.htm>> and OECD <<https://stats.oecd.org/Index.aspx?DataSetCode=REV>>.

Possible Directions for Future Fundamental Tax Reforms

- Value-added tax?
- Nordic dual income tax?
 - Low uniform tax rate on capital income
 - High progressive tax rates on labor income
 - For closely-held businesses, capital income is imputed based on a normal return to capital, and the rest is taxed as labor income
- Progressive consumption tax?
- Carbon tax?