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Analysis of The Tax Cuts and Jobs Act (TCJA)

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Abstract:

This paper will analyze the new tax law, The Tax and Jobs Act of 2017, which is effective from 2018-2025 in the United States. We will first examine the history of tax laws in the United States. Then we will focus our review on the effects that TCJA had on individual taxpayers. We will further discuss the importance of tax law in the United States, the current status of the law in the United States, the future of tax law in the United States, and finally address significant changes that occurred.

Introduction:

For many years the United States tax code was unchanged. The last major tax legislation was in 1986, the Tax Reform Act. That all changed in December 2017, when President Trump signed into law the Tax Cuts and Jobs Act (TCJA). This new tax legislation made major changes to the individual income tax and corporation taxes. The TCJA “is effective for tax years beginning after 12/31/17 and is currently set to expire on 1/1/26” (Shroff, 2018). However, they may be extended. Concerning, individual tax changes, TCJA covers issues such as, but not limited to, standard deduction, itemized deductions, income tax rates, etc. The goal of TCJA is “tax relief for middle-income families; simplification for individuals; economic growth through business tax relief; and repatriation of overseas earnings” (Xu, David, & Kim, 2018).

Importance of the topic:

Taxes are a monetary assessment imposed on individuals and businesses by the legislative branch of the government. Tax law is also always evolving in the United States. Therefore, tax law is important to study. Tax policy or law is used in the United States to raise revenue and to change sales tax rates to raise or lower the use of certain goods. Often tax codes are used to attain various economic and social goals. In addition, the government uses tariff policy to defend some industries from import competition. Therefore, tax laws have great significance.

On one hand, taxation is a critical way to reach the community’s distributional goals. The tax law creates revenue to aid local, state, and federal governments. Taxes pay for government jobs and services. It provides methods for producing social programs including education, public health services, and welfare. Also, it provides a means of financing the necessary public sector activities including the legal system, the courts, police protection, and national defense. Federal taxes support the President, Congress, federal judges, and the military salaries. State taxes provide benefits for roads, highways, state parks, and the governor. County and city taxes benefit schools, fire departments, and the local police department.

Without taxes, the government could not operate effectively. Taxpayers must have knowledge and have a general understanding of the impact taxes may have on their income.

History:

Taxation has been around in the United States since the colonial period. In the 1700s, Great Britain established several colonies in the United States. They believed they had the right to tax the colonies to pay for huge debts that occurred because of wars. The main source of revenue during that time was derived from tariffs and excise tax. Taxes were imposed on imports of goods and services. In 1764, the American Revenue Act also known as the Sugar Act, was passed. Its purpose was to reduce taxes on imported foreign molasses. The Stamp Act was passed in 1765 and imposed taxes on legal documents and printed paper that American colonists used. In 1767 the Townsend Act was passed which imposed taxes on goods imported to colonies such as tea, glass, and lead. The Townsend Act was repealed in 1770. In 1773 the Tea Act was passed, although it did not impose any new taxes on the colonies. However, it gave Britain a monopoly on the tea trade in the United States. The colonists grew frustrated with each new tax levied. They believed that this form of taxation was illegal because they had no representation. This led to the protest known as the Boston Tea Party. This was the final straw for the colonies which led to the American Revolution war.

Toward the end of the 1700s colonies demanded independence from Great Britain. As a result in 1776, the Declaration of Independence was signed into law. The Treaty of Paris officially ended the war in 1783 and the United States of America truly gained its independence. In 1789 Congress founded the Department of Treasury. Its purpose was to manage the nation's money and the Secretary of the Treasury's job was to come up with new ways to collect revenue. In 1790 Congress imposed taxes on whiskey to create more revenue. In the Tax Reform Act of 1976, "Congress considerably integrated the estate and gift taxes and created a set of rules governing generation-skipping transfer (GST) trusts" (Soldano and Palicz, 2016). This period was known as the customs duty era because most of the government revenue was generated from tariffs. They adjusted tariffs as revenue was needed.

The 1800s period in United States tax law is known as the excise tax era. Taxes were levied on specific forms of utilization or behavior. At the start of the period, the whiskey tax was repealed because it was too difficult to collect. The goal of the excise tax was to assist in wartime spending. The War of 1812 brought about the first internal sales taxes. Taxes were placed on gold, silverware, and watches. In 1817, internal taxes were eliminated. President Lincoln created the Bureau of Internal Revenue in 1862 with the mission to collect income tax for the newly established law to support the high cost of the Civil War. In 1868, taxes were levied on alcohol and tobacco. Unfortunately, income tax law was repealed in 1872. In 1894, Congress imposed a single tax rate on federal income tax. This was later ruled unconstitutional in 1896. This is because it was a direct tax that was not apportioned across the states based on population. In 1898 to raise revenue for the Spanish-American War, the death tax was created.

The income tax period in the United States began in the 1900's, as "tax legislation since it represents the beginnings of modern taxation policy" (King and Case, 2013). That same year Congress was granted the legal power to tax income on individuals and corporations with the 16th Amendment to the United States Constitution. The Revenue Act of 1916 created the estate tax. Over the next few years income tax rates rose from 15% and by 1918, they were as high as 77%. There were several revisions to the Revenue Act, which reduced taxes in the following years. In 1932 with the Great Depression taxes again rose to 63%. In 1933, the government repealed Prohibition to generate revenue from the excise tax on alcohol. To speed up the economic effort, the Social Security Act was passed in 1935. It established the Social Security program, which levied taxes on payroll to fund Social Security. The Revenue Act of 1942 raised taxes across the taxpayer pool. It also established new deductions for investment expenses and medical expenses. In 1943 the Current Tax Payment Act required businesses to withhold taxes from workers' wages and submit them quarterly. In 1944 the Individual Income Tax Act was passed. The goal was to simplify taxes in the United States, but it also raised individual income tax rates.

In 1981 Congress passed the Economic Recovery Tax Act (ERTA) which was the biggest tax cut in United States history and was signed into law by President Reagan. The Tax Reform Act of 1986 was also passed by President Reagan to simplify the income tax code. President George H.W. Bush passed the Revenue Reconciliation Act in 1990 to raise taxes on the rich. In 1993 President Clinton wanted to reduce the federal deficit and passed the Revenue Reconciliation Act. Shortly after in 1997, President Clinton also passed a tax law to cut taxes and implement the child tax credit. President George W. Bush established the new lowest tax rate of 10% in 2001 with the Economic Growth and Tax Relief Reconciliation Act. In 2004 the World Trade Organization ruled corporate tax provisions were illegal, so the United States eliminated them. For two years starting in 2009, President Obama cut taxes with the American Recovery and Reinvestment Act. In 2013 he also approved the permanent extension of President George W. Bush tax cuts for taxpayers below a specific income level. Over the next several years there were insignificant changes that took place.

Current Status:

On December 22, 2017, The Tax Cuts and Jobs Act (TCJA) was passed by President Trump. This piece of legislation affected individuals, corporations, nonprofits, and government bodies. Its goal was to reduce individual, corporate, and estate tax rates. The federal individual income tax brackets remained at seven with the "following temporary rates: 10%, 12%, 22%, 24%, 32%, 35%, and 37%, and would take effect for a taxable year beginning on January 1, 2018, and before January 1, 2026" (Marsan, 2018). Taxpayer

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group one rate remained the same at 10%, which is the minimum. Taxpayer group two rate dropped from 15% to 12%. Taxpayer group three rate was reduced from 25% to 22%. Taxpayer group four rate declined from 28% to 24%. Taxpayer group five rate fell from 33% to 32%. The taxpayer group six rate remains the same at 35%. Finally, Taxpayer group seven decreased from 39.6% to 37%.

Under TCJA, taxpayers can choose between using the standard deduction or itemized deductions. With the standardized deduction, it doubled from previous levels. Under TCJA, the standard deduction is now $12,000 up from $6,350 under previous law for single filers. For joint filers, the standard deduction increased from $12,700 to $24,000. Unfortunately, with the introduction of the new standard deductions, personal exemptions under the TCJA were mostly eliminated. Under prior tax law, they were $4,050 per individual. Thus the law drastically lowered the number of taxpayers who itemize deductions. Those who could itemize their deductions have new rules to go by. For all taxpayers, the itemized deduction for state and local taxes is limited to $10,000. Furthermore, if you divorce or separated in 2018, you can no longer deduct alimony because the payments are not taxable. Before 2018 the tax rules were still in effect. According to Fishman, "TCJA eliminated many personal expenses that used to be deductible, which makes it even harder to itemize, claim unreimbursed employee expenses, such as mileage, tax preparation expenses, alimony payments, investment expenses, and moving expenses to move to a new job" (Fishman, 2018). To qualify for a medical expense deduction taxpayer must exceed the 7.5% of Adjusted Gross Income (AGI) level for 2017-2019. It used to be 10% of AGI under previous tax law.

TCJA reduced home mortgage interest deduction. Currently, taxpayers can only deduct up to $750,000 of mortgage debt. It eliminated interest paid on equity loans as a deduction as well. There are some exceptions though. Prior tax law allowed for a deduction on home equity loans up to $100,000. TCJA does allow owners to deduct mortgage interest on their primary residence and a second home.

Under TCJA miscellaneous itemized deductions are not allowed at this point. Personal casualty and theft loss deduction is also not permitted. The exception to the law is an event declared by the President as an official disaster. TCJA eliminated AGI-based reduction of certain itemized deductions that were previously allowed. Furthermore, deductions for unreimbursed employee expenses were eliminated, along with tax preparation fees. Charitable contributions under TCJA increased by 10%. It is now 60% of adjusted gross income (AGI) and it previously was 50%.

The child tax credit with TCJA doubled to $2,000 for qualifying children from $1,000 under the previous tax law. The refundable portion under the additional child tax credit is up to $1,400 for each qualifying child. Furthermore, those taxpayers who cannot claim a child tax credit for dependents may be eligible for a $500 credit for other dependents with none of it being refundable. Additionally, TCJA expanded 529 plans where the funds may be used up to $10,000 a year for K-12 education and related expenses, not just for college expenses. Moreover, TCJA taxpayers will not pay taxes on federal and private student loan debt discharged from death or disability. The prior law made the estate pay taxes if the taxpayer passed or became disabled.

The estate, gift, and generation-skipping tax under TCJA a smaller number of estates is subject to a 40% tax. Oddly, under new law, the bigger estates will likely owe less taxes. The old law allowed the first $5 million of transferred property to be tax-exempt. The new law doubles the exempt amount temporarily to $10 million. Under TCJA, the annual gift exclusion is currently $15,000. It is up $1,000 from $14,000 in a previous couple of years.

Future:

According to Joint Committee on Taxation (JCT) estimates, "the new tax law will cost $1.5 trillion over the next decade; will only modestly improve economic growth — enough to recoup only about one-quarter of these costs" (Marr, Duke, and Huang, 2018). There is no certainty where income tax rates will be in the future. We can look at historical trends from an economic perspective and see that this will mean higher income tax rates. As well as if we look at political trends the tax rate will be higher as well. Taxpayers need to be prepared and ready if there are changes to future tax laws.

Some way for taxpayers to be prepared is to adjust their W-4, to make sure they have enough taxes withheld out of their income to cover the tax liabilities that they would owe under the new laws. Another way to be prepared is to talk to your accountant about the new tax laws and how their changes will affect your personal and business returns. Accountants will be able to inform you on what you need to do and help you get things started and in place so when it is time to file your return you are not shocked by the bottom line and see the total that is owed.

To conclude, in 2025, with TCJA most of the individual income tax changes are set to expire. At that time Congress will need to review the law and decide which part of the law we should keep because it's working and which ones we should get rid of. The goal should be to serve the masses and relieve the burden of middle-class taxpayers. They should continue to focus on making taxes straightforward and reduce complications. They also need to review and implement laws in areas that TCJA did not cover that is beneficial to the masses.

Conclusion:

In summary, The Tax Cuts and Jobs Act became effective January 1, 2018, through 2025 and significantly changed tax law. Its focus was on cutting individual, corporate, and estate tax rates. All taxpayers are affected by the new changes with TCJA, and they must carefully consider the impact on their specific financial situation. The new tax law has made it simple for most taxpayers

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to file their taxes. It doubled the standard deduction thus, eliminating the need for most taxpayers to itemize deductions. It also doubled the child tax credit and increased the refundable portion of the child tax credit by 40%.

In addition, TCJA gave some flexibility in 529 plans and drastically increased estate tax exemptions. Regarding businesses it noticeably lowered the income tax rate for corporations. It also gives a substantial deduction for owners of pass-through entities. Additionally, it made major changes related to the taxation of foreign income. The law is set to expire in 2025 but may be extended or may change with a new administration. TCJA's biggest benefactors are the wealthy taxpayers. The middle class bears the burden, and the lower class has no effect because they do not earn enough money to pay taxes. The effects of TCJA are not beneficial to the masses. Thus, legislators need to reform the tax law in 2025 and write meaningful legislation that will reverse the damage that was caused by TCJA. In addition, TCJA needs to close the gap between upper- and lower-class taxpayers and loopholes that benefit corporations. Taxpayers desperately need an effective policy that is fair and requires all taxpayers to pay their equitable portion.

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