National Small Business Network

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The Real Impacts of "The Tax Cuts and Jobs Act"

As conservative business people who understand economics and the effects of tax policy on the economy, we cannot understand how thoughtful Republicans can support the Trump tax cuts proposed in "The Tax Cuts and Jobs Acts. Looking at the long-term impacts of the proposed changes, we see problems for the economy; for businesses; for employment; and ultimately for the Republican party and our 2-party political process.

Anyone with a broad understanding of economics, knows that this is exactly the wrong time for a major unfunded tax reduction. There are times of crisis when the economy is in a recession and government needs to borrow against the future to stimulate the economy through direct spending or tax cuts. However, the economy is now at a peak, with 8 years of steady growth. As President Trump just wrote in USA Today "...unemployment is at a 16-year low. Wages are rising. Manufacturing confidence is higher that it has ever been. The stock market is soaring to record levels. And GDP growth climbed to more than 3% in the second quarter**."** **This is the time to increase revenue to pay down our dangerously high national debt, and invest in programs and infrastructure for the future, not give tax cuts primarily to the wealthy who have benefitted the most from this economic growth.**

Most importantly the "Tax Cuts and Jobs Act" (TCJA) doesn't actually cut taxes overall, it just redistributes them and postpones $1.5T in taxes, by adding to the national debt. This will have to be paid back, with interest, by all tax payers in future years. Taxes will have to rise dramatically in the future, just to pay current debt, and it is irresponsible to increase the debt by another 6% over 10 years, or another $9800 per taxpayer. After years of continued deficit spending, almost 10% of last year's discretionary budget was spent just paying the interest on debt from past spending, even at today's still historically low interest rates. Poor fiscal management with too much spending and too little tax revenue has already put a burden of over $750,000 in Federal debt obligations on every American family. Federal spending is currently about 21% of GNP, estimated by CBO to rise to 23% by 2026, but tax revenue is only about 17.4% of GNP. Last year's official deficit, alone, was over $587 Billion, for a total current sovereign debt of over $19.7 Trillion. This is over 77% of our annual Gross National Product, and is over 13 times total annual Federal Income Tax revenues. Even these amounts do not include the large unfunded future obligations for federal retirement benefits, veteran's benefits, Social Security, Medicare, and Medicaid, which are currently estimated to be over $127 Trillion, or over 57 times total current annual Federal tax revenues. Knowledgeable Republicans, and most economists know this massive debt will reduce future economic growth, and threaten our fiscal solvency. This year's CBO projected deficit, before the proposed tax cuts, is 3.1% of total GDP and will actually exceed the total growth in real GDP. If HR1 passes, CBO estimates the deficit will increase by $1.5 Trillion, and reach 97% of total GNP in 2027. We are just playing a Ponzi game by borrowing against our country's, and our children's, future, instead of balancing our budget the way taxpayers, businesses, and states do. There is absolutely no logic in adding $1.7 trillion to $2.4 trillion in un-needed debt over the next 10 years, and probably more in future years.

The bill's title is refreshingly honest that it is a "Tax Cut" not strategic tax reform. It is wrong, however, to imply that it will grow jobs, because it has the wrong policies to generate sustainable long-term economic growth. Regardless of the political rhetoric, the tax cuts will disproportionally benefit the wealthy upper 1% of taxpayers, based on the JCT distribution analysis of HR1 by income group, and adding the effect of the estate tax changes not included by JCT. The Center on Budget and Policy Priorities, analysis concludes: "Households with annual incomes over $1M will see their after-tax income increase by 3.2%, 16 times the increase for any income group in the bottom half. About 45% of the bill's tax cuts would go to households with incomes above $500,000 (fewer than 1 % of filers). About 38% of the bill's cost would go to tax cuts for households with incomes over $1M (about 3 out of 1000 filers)"

Economic research shows the wealthy 1% will generally <u>not</u> use the extra dollars they receive from lowered rates to start new businesses or create new jobs. They won't even spend most of it to create secondary economic activity the way lower income tax cuts, or direct federal spending would. The wealthy will primarily use the tax savings to bid up the price of assets such as traded stocks, precious metals, and real estate which adds little or nothing to real economic growth. Except for IPO stock, none of the money invested in traded stocks or existing real estate actually goes to a business or creates new direct jobs. Twenty percent of any increase in the value of traded stocks will also go to foreign owners who will pay no US taxes when they sell them. Repeated economic analysis of other unfunded tax cuts has demonstrated that they never generate enough economic activity to pay for the cuts. There is also no logic in the major reductions of Federal programs in the Budget that would statistically contribute more to general economic growth than the tax cuts for the wealthy they would fund. Realistic Republicans should know that no matter how well you try to spin the words, the numbers that voters will eventually see cannot lie.

As if borrowing $1.7 Trillion, or more, from future generations and future economic growth wasn't enough, the Senate may also repeal the ACA health insurance subsidies to help pay for the cuts. In Budget scoring, it reduces Federal insurance subsidies and state Medicare reimbursements by $3.38 Billion per year. However, in societal costs, CBO estimates it does this by reducing the number of citizens with health insurance by 14,000,000 in 2027. Without insurance, they will receive less preventative care and incur more high cost emergency room and hospital care, which everyone else will pay for in higher employer and individual health insurance premiums. As with automobile insurance, everyone benefits when everyone has basic coverage.

Reducing the number of tax brackets does not simplify the tax code, it just reduces the rate progressivity. Whether there are 3 brackets or 300, the simple math calculation is the same. What it does mean is that under the proposal, a family with $260,000 of income will pay the same rate as a taxpayer with up to $1 Million in income. That is not an equitable impact on the lives of middle class families.

The higher standard deduction will provide filing simplicity for lower income taxpayers, but it may also be a temptation that keeps them from taking deductions and credits Congress specifically put in place to help individuals grow out of poverty. The elimination of personal exemptions and other credits also offsets much of the increase. Many current provisions, like deductibility of student loan interest and the deduction for employer provided child care are specifically repealed. Elimination of deductions such as employee business expenses and limitations on other itemized deductions will probably increase taxes for many, particularly single taxpayers.

The elimination of individual deductibility for state and local taxes, except up to $10,000 in real property taxes in the House version, also totally contradicts the belief of many Members of Congress that government services are best provided at the state and local level, by seriously reducing the ability to fund local services. Unlike the Federal government, most states have balanced budget requirements and constitutional limitations on raising taxes or local levies for cities and schools without specific voter approval. Inability to fully deduct these taxes significantly reduces voter support for local taxes needed for schools and infrastructure because voters feel it is a "double tax" on income they never actually received. Elimination of the interest exemption on qualified local improvement bonds will also reduce the ability of states and cities to maintain infrastructure and increase the demand for more federal funding.

The Alternative Minimum Tax filing threshold should be increased to maybe $200,000 of AGI, but the AMT should <u>not</u> be eliminated. It was put into the code for the logical purpose of preventing wealthy taxpayers, like

President Trump, with high levels of accelerated write-offs and other tax credits and incentives from escaping reasonable taxation.

Itemized deductions and all tax incentives should be regularly reviewed for their actual economic or societal value. But, blindly eliminating the many strategic tax incentives, passed by both parties in prior Congresses, is wrong, without a detailed review of their cost effectiveness. The two major tax incentives mentioned for retention, home mortgage interest and charitable contributions, disproportional benefit higher income taxpayers, particularly with elimination of the "Pease" phaseout for deductions at higher incomes. Many of the current deductions and credits that would be eliminated are also specifically targeted, by income limitations or other qualifications to benefit only lower income or disadvantaged taxpayers.

Estate and Generation Skipping Taxes should <u>not</u> be repealed in 2024 as purposed by the House, because full repeal will benefit only a few hundred super-wealthy families, and would continue the growing class split in our economy. It is important, instead, to continue the re-valuation in basis at death, which would otherwise impact all taxpayers, including 99% of small businesses, with high capital gains taxes on the inflated value of old assets when they are later sold. Estate taxes actually affect less than 100 family businesses or farms a year at the current $11 Million exemption, and would affect even fewer at the increased $10M/$20M exemption. The basis adjustment at death should only apply to estates under the exemption level, or on assets on which an Estate Tax has been paid. The Estate Tax is not really double taxation because much of the value of larger estates is from gain in the value of assets that has never been recognized or taxed and would completely escape taxation if the Estate Tax was repealed in addition to a step-up in basis.

Maintaining international competitiveness for US multinational corporations (MNC), while also eliminating their US tax avoidance from using profit shifting and corporate inversions is important, but cutting the corporate rate and reducing overall tax revenues from businesses is <u>not</u> the solution. The TCJA proposals for lower rates and "territorial taxation" would actually make tax avoidance by profit shifting permanent, and is exactly the wrong approach. Instead, Formulary Allocation of <u>worldwide</u> income based on country of sale, as used for most state corporation income taxes, treats US and foreign MNCs equally, and would allow down to a 0% tax rate on export sale profits, while maintaining overall corporation tax revenues. US corporate profits and cash reserves, even after taxes, are already at record highs and most investment analysists expect MNCs to use any additional tax savings mostly for stock buy-backs and increased dividends which will primarily benefit high income investors.

Tax rates on Pass-through entities such as proprietorships, partnerships, and "S" corporations should be equitable with "C" corporations with reasonable adjustment for the double layer of taxation. But HR1 may overall be negative for small businesses growth. There is a need to control potential abuse in characterizing personal wages as business income. However, the assumption in HR1 that 70% of the net income of a pass-through business should be taxed as regular income of the owners, unless the business can prove otherwise, is unreasonable. By automatically giving the lower 25% passthrough rate to passive investors, but only allowing the lower rate on 30% of distributions to active owners who actually make decisions about growing the business and hiring more employees, the bill sends the wrong message. It tells small business people, why put up with the long hours, frustrations, and risks of running your own business when you can get a lower tax rate by closing the business and just making passive investments.

Instead, a carefully controlled incentive, more like the Senate proposal, should be provided for owner investment and re-investment in small businesses versus traded sector speculative investments which have little economic growth value. A limited lower tax rate on pass-through income from a small business in which the taxpayer "materially" participates; meets IRS reasonable compensation requirements; meets the business type requirements for exemption from the Individual Investment Income Tax; and is dollar limited to $500,000 from <u>all</u> pass-through entities, per taxpayer, per year, is a reasonable way to incentivize small business and job growth.

"Unprecedented expensing" of business investments is <u>not</u> needed now, at the height of the business cycle, and is bad tax policy. Although unlimited expensing might provide a short-term economic boost, it is un-needed, and would result in reduced tax revenue from the government essentially providing free financing for business purchases. Long-term, it will also hit businesses with higher taxes for which they may not have saved reserves. Amortizing capital investments over the useful life of an asset is really a good business policy. Full expensing also destroys the important Congressional tool of Bonus Expensing to help the economy recover from the next recession. With the current availability of labor cost reduction technology and automation, many businesses would probably use the expanded expensing capability to further replace employees with equipment. Small businesses already have $500,000 and more in asset expensing ability, which is far more than most small businesses can use annually.

Finally, responsible Members of Congress know there has not been adequate due diligence of the major tax changes proposed, or any "transparent and inclusive committee process" as was specifically called for in the "Framework". The current process looks tainted by special interest one-sidedness and lack of effective bi-partisan Congressional involvement and agreement. There are better solutions for the few legitimate tax concerns such as international economic competitiveness. No action is better than the wrong action, and carefulness in legislation is always respected by voters. The ultimate blame for the economic consequences of this bill, if passed, will clearly fall on this Congress and the Republican Party.

Stop this short-sighted process until we can do true strategic tax reform, and do it correctly!

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