CENTER FORWARD

# The Tax Cuts and Jobs Act - Tax Series Part 2 of 5

Center Forward Basics

November 2024

## Overview

The **Tax Cuts and Jobs Act (TCJA)**, passed in December 2017, represents one of the most significant overhauls of the U.S. tax system in decades. The act was designed to spur economic growth by reducing the tax burden on individuals and businesses. For individuals, the TCJA lowered income tax rates, increased the standard deduction, and made several changes to deductions and credits, impacting taxpayers at various income levels. For businesses, the corporate tax rate was cut to make U.S. companies more competitive globally.

The primary goals of the TCJA were to encourage job creation, increase wages, and boost investment by putting more money into the hands of consumers and businesses. By lowering the rate and broadening the tax base, the law sought to incentivize companies to expand, hire more workers, and invest in new technologies while also making the U.S. more attractive for corporations. Additionally, the act introduced changes to international tax rules, which aimed to stem the rash of corporate inversions and encourage U.S. companies to bring back profits held overseas. However, the long-term effectiveness of the act in achieving sustained economic growth continues to be debated.

In this Basic, we will examine the TCJA's history, future proposed changes, and upcoming expiration.

### Center Forward Basics



## How Did We Get Here?

The Tax Cuts and Jobs Act (TCJA) was developed against a backdrop of slow economic recovery following the 2008 financial crisis. By 2017, while the U.S. economy had regained much of its pre-recession strength, growth remained modest, and wage increases were slow. Policymakers sought ways to stimulate further economic expansion, create jobs, and encourage investment, particularly as other nations had recently lowered their corporate tax rates, making the U.S. less competitive in the global market.

Widespread concern about the complexity of the U.S. tax code was also present, and significant reform had yet to be undertaken since the Tax Reform Act of 1986. Calls for simplifying the tax system and reducing the regulatory burden on businesses gained momentum, especially among Republicans, who believed lower taxes would lead to greater economic efficiency.

The debate surrounding the TCJA was highly polarized. Republicans argued the bill would spur economic growth by reducing taxes for both individuals and corporations, encouraging business investment, and creating jobs. The Trump Administration argued that cutting taxes for individuals and corporations would lead to significant job creation and wage growth. Despite opposition from Democrats, who criticized the bill as disproportionately benefiting the wealthy and corporations while increasing the national debt, the TCJA passed along party lines in December 2017. It passed the Senate 51-48 and the House 227-203, with no Democrats voting in favor.

## Digging Deeper

The Tax Cuts and Jobs Act lowered tax rates for individuals by reducing the rates across most income brackets. The seven-bracket system remained, but the rates were generally reduced, with the top marginal tax rate dropping from 39.6% to 37%. This adjustment aimed to provide tax relief across income levels, though higher-income earners received larger cuts in percentage terms.

One of the most significant changes was the doubling of the standard deduction. For single filers, the deduction increased from $6,350 to $12,000; married couples filing jointly rose from $12,700 to $24,000. This change simplified tax filing for many households by encouraging more taxpayers to take the standard deduction rather than itemize their deductions, as fewer itemized deductions would exceed the new, higher standard deduction threshold.

At the same time, the TCJA capped deductions for state and local taxes (SALT) at $10,000. Previously, taxpayers could deduct the total state and local property taxes and state income or sales taxes. The $10,000 cap disproportionately affected taxpayers in high-tax states, where state and local taxes often exceed the new limit. This was a contentious provision, as it limited the benefits of tax cuts for some individuals in these states.

The TCJA also significantly changed corporate taxation by reducing the corporate tax rate from 35% to 21%, one of the most significant decreases in U.S. history, while expanding the tax base to include all income earned by U.S. companies overseas. The goal was to make the U.S. more competitive globally by aligning the corporate tax rate with those of other advanced economies, many of which had already lowered their rates.

In addition to lowering the corporate tax rate, the TCJA also introduced significant reforms to the international tax system, shifting the U.S. from a worldwide tax system to a more territorial system. Under the previous system, U.S. multinational corporations were taxed on their global earnings, regardless of where they were earned. Still, they could defer paying U.S. taxes on foreign profits until those earnings were returned to the U.S. This led many companies to leave profits overseas rather than face the higher tax rate upon repatriation, upon repatriation to the United States.

To address this issue and to move away from the system of worldwide taxation into a quasi-territorial regime, the TCJA introduced a one-time repatriation tax on overseas profits, requiring companies to pay a “transition tax” on all of their unrepatriated foreign earnings at a reduced rate of 15.5% for cash and 8% for non-cash assets. The new quasi-territorial system allowed U.S. companies relief from double taxation on foreign earnings while instituting the new Global Intangible Low-Taxed Income (GILTI) regime to ensure that all of a U.S. company’s foreign earnings are subjected to a minimum level of U.S. taxation. The intent of TCJA was to encourage U.S. companies to repatriate their overseas profits, reinvest them in the U.S. economy, and make it more attractive to earn income in the U.S.

## Provisions & Expirations

Several individual tax provisions introduced under the TCJA are set to expire at the end of 2025, which could significantly impact taxpayers. Tax rates and deductions will revert to pre-2018 levels when these provisions expire unless Congress acts to extend or revise them. Some of these fundamental changes include:

- **Reversion of Lower Tax Rates**: The lower individual income tax rates, which were reduced across most income brackets, will revert to their previous, higher levels. Many taxpayers could see their tax bills increase if no new legislation is passed.
- **Standard Deduction**: The doubled standard deduction will also revert to its pre-TCJA amount. This could lead more taxpayers to return to itemize their deductions.

- **State and Local Tax (SALT) Deduction**: The $10,000 cap on the SALT deduction is also set to expire. If Congress does not extend or modify this provision, taxpayers in high-tax states could again fully deduct their state and local taxes.
- **Child Tax Credit**: The expanded child tax credit will be reduced to its original amount. Additionally, the refundable portion of the credit, which benefits lower-income families, will decrease.

- **R&D Deduction:** Prior to changes in the 2017 tax law, businesses were entitled to a full deduction in the year in which the R&D expenses were incurred. The law changed the upfront deduction to a process of spreading out the costs over years, known as "amortization." Amortization requires that if a company spends money on developing new products or technologies, it must write off those costs gradually over several years on its tax returns rather than recoup the full tax benefit of a deduction in one year.

Congress faces a critical decision on how to handle these expirations. Extending the tax cuts would likely garner support from those who favor lower taxes, but it could also raise concerns about the growing federal deficit. On the other hand, allowing these provisions to expire would likely be unpopular with many taxpayers, especially those who have benefited from the increased standard deduction and lower rates.

There may be bipartisan pressure to compromise, with potential reforms targeting specific provisions, such as revisiting the SALT cap or modifying the income tax brackets to avoid a complete reversion to pre-2018 levels. The outcome will likely depend on the political landscape and economic conditions leading up to 2025, making it a significant issue for the next Congress and presidential administration.

Ultimately, the adjustments made to the tax code will depend on the political landscape, the state of the economy, and public sentiment regarding taxation and government spending. Balancing the need for revenue generation with the potential impact on economic growth and income inequality will be a crucial challenge for policymakers in the coming years.

## Reflection

The TCJA is a landmark piece of legislation that fundamentally reshaped the U.S. tax system to promote economic growth, job creation, and corporate competitiveness. Its significance lies in the substantial reduction of tax rates for individuals and corporations, the doubling of the standard deduction, and introducing a deduction on qualified business income for pass-through entities. These measures aimed to stimulate investment and consumer spending, fostering an environment conducive to economic expansion.

While the initial economic indicators showed growth, including a boost in GDP and stock market performance, critics argue the long-term impacts have not met expectations. Wage growth has remained sluggish for many middle- and lower-income earners, and income inequality has continued to rise. The TCJA has also been largely successful in achieving its objectives, including the elimination of corporate inversions, the broadening of the corporate tax base, and the generation of increased revenue from corporate taxes through these base-broadening measures. It is estimated that the TCJA would boost economic activity by an average of about 0.7 percent over the budget window. That growth would then reduce the deficit impact by about $385 billion—a $451 billion boost to revenues. Including any macroeconomic effects, TCJA would thus increase the deficit by slightly less than $1.1 trillion over a decade.

The continuing debate over the effectiveness of the TCJA centers on its ability to achieve sustainable economic growth and the implications of increased federal deficits. While proponents claim lower tax rates will lead to increased economic activity, detractors highlight concerns over the growing national debt and the potential need for future tax increases to offset the revenue losses. As the expiration of critical provisions approaches in 2025, the discussion around the TCJA will likely intensify, prompting policymakers to evaluate its legacy and consider adjustments to ensure a more balanced and equitable economic future.

## Links to Other Resources

- Bipartisan Policy Center - The 2025 Tax Debate: Individual Tax Deductions and Exemptions in TCJA
- Brookings - Which provisions of the Tax Cuts and Jobs Act expire in 2025?
- IRS - Tax Cuts and Jobs Act: A comparison for businesses | Internal Revenue Service
- Tax Foundation - Options for Navigating the 2025 Tax Cuts and Jobs Act Expirations
- Tax Policy Center - How did the Tax Cuts and Jobs Act change personal taxes? | Tax Policy Center