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HEARING ON 2017 TAX LAW: IMPACT ON THE BUDGET AND AMERICAN FAMILIES

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, D.C., FEBRUARY 27, 2019

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HEARING ON 2017 TAX LAW: IMPACT ON THE BUDGET AND AMERICAN FAMILIES

WEDNESDAY, FEBRUARY 27, 2019

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The Committee met, pursuant to notice, at 10:06 a.m., in Room 210 Cannon House Office Building, Hon. John A. Yarmuth [Chairman of the Committee] presiding.

Present: Representatives Yarmuth, Scott, Doggett, Jackson Lee, Schakowsky, Higgins, Peters, Sires, Panetta, Horsford, Omar; Womack, Flores, Johnson, Woodall, Smith, Hern, Burchett, Crenshaw, and Meuser.

Chairman YARMUTH. The hearing will come to order. I would like to begin with an announcement. I am pleased to announce that Mr. Seth Moulton is designated as the new vice chair of the committee. I look forward to working with Vice Chair Moulton and welcome his leadership.

And now I want to welcome everyone to the Budget Committee hearing. This hearing will focus on the impact of the 2017 tax law on the budget and on American families. I especially want to thank our great panel for being with us this morning.

Today, we will be hearing from Dr. William Gale, Arjay and Francis Miller Chair in Federal Economic Policy at the Brookings Institution and co-director of the Tax Policy Center. We will hear from Chye-Ching Huang, director of federal fiscal policy at the Center on Budget and Policy Priorities. We welcome Caroline Bruckner, professor at American University and the managing director of the Kogod Tax Policy Center. And Lana Pol, president of Geetings, Inc., headquartered in Pella, Iowa.

Now, I yield myself five minutes for my opening statement.

Once again, welcome to our witnesses. I want to apologize this morning to everyone here. We tried to find a tax expert, named Michael Cohen, thinking it would generate more attention. We were unable to do so. But again, we have an esteemed panel.

We are here today to talk about the impact of the 2017 tax law on the federal budget and American families. It is a conversation my Democratic colleagues and I tried to have with our Republican counterparts more than a year ago. But instead of collaborating on bipartisan, middle class-focused tax reform, and instead of heeding the warnings of economists, the Congressional Budget Office and even our own constituents, congressional Republicans chose to enact massive tax cuts for the wealthy and large corporations, which we will discuss today. They did this on their own, behind

closed doors, in the dead of night and without time for debate or any public scrutiny. And I exclude all my Republican colleagues here. I don't think anyone here was involved in that, in that process. Though most who are here did vote for it.

That bill was enacted in such a hurry that senators were forced to read handwritten changes in the margins of the bill text, if they had time to read it at all. It is one of the reasons why there have been requests for more than 70 corrections to the tax bill coming from Senate Republicans, at least.

This tax law was based on the flawed notion of trickle-down economics, which has totally been discredited. The idea that tax cuts for the wealthiest Americans and for corporations will trickle down and raise the standard of living and incomes for everyone else. We know that has not happened.

Under the Republican tax law, nearly all the tax cuts are going to the top 1 percent and corporations. The richest 1 percent alone are receiving more than 80 percent of the total benefits. Our long-term economic growth trajectory has not improved, the federal deficit is soaring as corporate tax receipts plummet. There is no sign of an investment boom. Wage growth for workers remains weak and woefully inadequate. Most small business owners have seen few, if any benefits.

Because of changes in this law, factories and jobs are more likely to go overseas. There are even more special interest tax loopholes for the wealthy than before. And that promise of being able to do your taxes on a postcard—well, we are still waiting for that one.

Since the President signed this bill into law, we have seen a record-setting $1 trillion in stock buybacks, buybacks that make rich investors richer and fuel rising CEO pay. And, by the way, about a third of the benefits of those stock buybacks go to foreign investors. They do almost nothing to improve business operations or help the average worker. They have not improved our economic outlook and, as our witnesses believe, will ultimately worsen income and wealth inequality. And due to perverse international tax incentives in the law, it is possible for companies to actually reduce their taxes significantly more or avoid paying tax altogether—by generating income overseas and moving investments abroad. This endangers more than 15 million American workers whose jobs are vulnerable to being offshored.

For American families, this law is a huge and predictable failure. For the federal budget, it is a huge and predictable drain. And that is because the premise on which this tax legislation was built, that it would magically pay for itself, is fundamentally flawed. As we will hear today, the GOP tax law has significantly weakened our budgetary health. It has caused more than a 30 percent drop in corporate receipts in 2018, with total receipts as a share of GDP falling to the lowest level since the end of the great recession. This is despite healthy economic growth and a tight labor market.

As we engage in our oversight function, today we will not only discuss what the impact of the tax cuts have had on the budget but how they will impact the economy and American families going forward. Our budgetary challenges, and we have many, require smart, fiscally responsible policies, and the American people are demanding it.

Today, we are going to find out just how deep the damage goes. We will look at the facts about the tax law's impact on American families. And we will set the stage for taking necessary action to move our nation's fiscal policies in the right direction. I thank our witnesses for helping us with this discussion and I look forward to hearing from you.

I now yield five minutes to the ranking member, Mr. Womack.

[The prepared statement of Chairman Yarmuth follows:]

Yarmuth Opening Statement

2017 Tax Law: Impact on the Budget and American Families

February 27, 2019

Once again, welcome to our witnesses. We are here today to talk about the impact of the 2017 tax law on the federal budget and American families. It is a conversation my Democratic colleagues and I tried to have with our Republican counterparts more than a year ago.

But instead of collaborating on bipartisan, middle-class focused tax reform, and instead of heeding the warnings of economists, the Congressional Budget Office, and even our own constituents, Congressional Republicans chose to enact massive tax cuts for the wealthy and large corporations, which we will discuss today. They did this on their own, behind closed doors, in the dead of night, and without time for debate or any public scrutiny.

And I exclude all my republican colleagues here. I don't think anyone here was involved in that process, although most who were here did vote for it.

That bill was enacted in such a hurry that Senators were forced to read handwritten changes in the margins of the bill text, if they had time to read it at all.

That's one of the reasons why there have been requests for more than 70 corrections to the tax bill, coming from Senate Republicans, at least.

This tax law was based on the flawed notion of trickledown economics. Which has totally been discredited. The idea that tax cuts to the wealthiest Americans and corporations will trickle down and raise the standard of living and incomes for everyone else.

We know that hasn't happened. Under the Republican tax law nearly all the tax cuts are going to the top 1% and corporations. Richest 1% alone are receiving more than 80% of the total benefits.

Our long-term economic growth trajectory has not improved. The federal deficit is soaring as corporate tax receipts plummet. There is no sign of an investment boom. Wage growth for workers remains weak and woefully inadequate. Most small business owners have seen few, if any benefits.

Because of changes in this law, factories and jobs are more likely to go overseas. There are even more special interest tax loopholes for the wealthy than before. And that promise of being able to do your taxes on a postcard—well, we're still waiting for that one. Since the president signed this bill into law, we've seen a record setting $1 trillion in stock buybacks—buybacks that make rich investors richer and fuel rising CEO pay. And by the way, about a third of the benefits of those stock buy backs go to foreign investors. They do almost nothing to improve business operations or help the average worker. They have not improved our economic outlook and as our witnesses believe, will ultimately worsen income and wealth inequality.

And due to perverse international tax incentives in the law, it is possible for companies to actually reduce their taxes significantly more—or avoid paying tax altogether—by generating income overseas and moving investments abroad. This endangers more than 15 million American workers whose jobs are vulnerable to being offshored.

For American families this law is a huge and predictable failure. For the federal budget it's a huge and predictable drain. And that is because the premise on which this tax legislation was built, that it would magically pay for itself, is fundamentally flawed.

As we are here today, the GOP tax law has significantly weakened our budgetary health. It has caused more than a 30 percent drop in corporate receipts in 2018, with total receipts as a share of GDP falling to the lowest levels since the end of the Great Recession. This is despite healthy economic growth and a tight labor market.

As we engage in our oversight function, today we will not only discuss what the impact of the tax cuts have had on the budget, but how they will impact the economy and American families going forward.

Our budgetary challenges—and we have many—require smart, fiscally responsible policies, and the American people are demanding it. Today, we are going to find out just how deep the damage goes. We will look at the facts about the tax law's impact on American families. And we will set the stage for taking necessary action to move our nation's fiscal policies in the right direction. I thank our witnesses for helping us with this discussion and look forward to hearing from you.

Mr. WOMACK. I thank the chairman for holding this important hearing and thank you to our witnesses for being here today. By the way, in case you didn't pick up on it, Chairman Yarmuth is not a big fan of the Tax Cuts and Jobs Act. I kind of just wanted to state that for the record.

I would like to extend a warm welcome to Lana Pol, a second-generation business owner from Pella, Iowa. Thank you, Ms. Pol, for traveling to Washington, D.C., to share your story with us. I look forward to your testimony.

As we will hear from the gentlelady from Iowa, the Tax Cuts and Jobs Act is working. It is delivering meaningful relief to workers, families, job creators, and communities across the country after years of sky-high taxes and a sluggish economy.

A little more than a year after President Trump signed the Tax Cuts and Jobs Act into law, our economy is strong again, with more than double the GDP growth seen during the Obama administration, and Americans are feeling the difference every day. Americans are seeing bigger paychecks, getting to keep more of their hard-earned money to save, spend and invest the way they see fit. Wages and salaries increased by more than 3 percent in 2018, the largest percent increase in more than a decade. According to the nonpartisan Tax Foundation, 80 percent of wage earners have seen an increase in their take-home pay.

Americans are seeing more jobs. There are 7.3 million job openings, the most job openings since 2000 when the Department of Labor first started recording this data. Unemployment fell to the lowest level since the 1960s in 2018 at 3.9 percent, and CBO projects unemployment will continue to decline to 3.5 percent in 2019.

Americans are feeling more optimistic about the future. Consumer confidence is at an 18-year high. And, according to a new Gallup Poll released earlier this month, nearly 70 percent believe their personal finances will continue to improve next year.

Job creators in my district are seizing on this opportunity. One of my constituents, Rick Barrows, runs Multicraft Contractors, a construction and industrial services business with roughly 700 employees. In talking with Rick, it is clear how the Tax Cuts and Jobs Act has made a meaningful difference, not only for him and his family, but for all of his employees. With lower taxes, Rick was able to double the employer contribution to his employees' 401(k)s. He was able to invest in leadership and workforce development. And, with the ability to immediately write off the cost of capital investments, Rick was able to dramatically expand his operation, acquiring and renovating an adjacent property, ensuring his business can continue to grow. Now, these are the real-world benefits that I am hearing from back home.

Despite these successes, some of my colleagues on the other side of the aisle are looking for ways to reverse this progress and increase taxes on hardworking Americans, all so they can pay for more expensive government-run programs. As we recently heard from the CBO director, Dr. Keith Hall, these efforts are likely to have significant negative consequences for our economy and constituents we represent. All of us sitting on this dais today have a

responsibility to get our fiscal house in order. And raising taxes that will stifle growth and investment is not the answer.

As I have said before, we do not have a revenue problem—in fact, quite the opposite. With the Tax Cuts and Jobs Act, federal revenues in Fiscal Year 2019 are expected to increase by $186 billion. What we have is a spending problem, a fact many Democrats are choosing to ignore. Today, mandatory spending accounts for about 70 percent of all federal spending. Without taking into account proposals for massive new trillion-dollar entitlement programs, mandatory spending is expected to increase to 78 percent at the end of the 10-year budget window.

I hope that our discussion today illuminates for my colleagues on the other side of the aisle that the Tax Cuts and Jobs Act is helping local business owners, like Ms. Pol, to create more jobs, increase paychecks and create more economic opportunities for families. And to truly address the fiscal challenges facing our nation today and future generations, we must tackle the core driver of our ballooning debt, and that is out-of-control spending.

With that, Mr. Chairman, I thank you for the opportunity and I yield back my time.

[The prepared statement of Steve Womack follows:]



HOUSE
BUDGET
REPUBLICANS

Ranking Member Steve Womack (R-AR) Opening Statement

(As Prepared For Delivery)

Thank you, Chairman Yarmuth, for holding this important hearing, and thank you to our witnesses for being here today. I especially want to extend a warm welcome to Ms. Lana Pol, a 2nd-generation family business owner from Pella, Iowa. Thank you, Ms. Pol, for traveling to Washington, D.C., to share your story with us.

As we will hear from Ms. Pol today, the Tax Cuts and Jobs Act is working. It is delivering meaningful relief to workers, families, job creators, and communities across the country after years of sky-high taxes and a sluggish economy.

A little more than a year after President Trump signed the Tax Cuts and Jobs Act into law, our economy is strong again – with more than double the GDP growth seen during the Obama Administration – and Americans are feeling the difference every day.

Americans are seeing bigger paychecks – and getting to keep more of their hard-earned money to save, spend and invest the way they see fit.

Wages and salaries increased by more than 3 percent in 2018 – the largest percent increase in more than a decade. According to the nonpartisan Tax Foundation, 80 percent of wage earners have seen an increase in their take-home pay. Americans are seeing more jobs.

There are 7.3 million job openings – the most job openings since 2000, when the Department of Labor first started recording this data. Unemployment fell to the lowest level since the 1960s in 2018 at 3.9 percent, and CBO projects unemployment will continue to decline to 3.5 percent in 2019.

Americans are feeling more optimistic about the future. Consumer confidence is at an 18-year high, and, according to a new Gallup poll released earlier this month, nearly 70 percent believe their personal finances will continue to improve next year.

Job creators in my district are seizing this opportunity. One of my constituents, Rick Barrows, runs Multi-Craft Contractors – a construction and industrial services business with roughly 700 employees. In talking with Rick, it's clear how the Tax Cuts and Jobs Act has made a meaningful difference, not only for him and his family, but for all of his employees.

With lower taxes, Rick was able to double the employer contribution to his employee's 401(k)s. He was able to invest in leadership and workforce development. And, with the ability to immediately write off the cost of capital investments, Rick was able to dramatically expand his operation, acquiring and renovating an adjacent property – ensuring his business can continue to grow. These are the real-world benefits I'm hearing about back home.

Despite these successes, some of my colleagues on the other side of the aisle are looking for ways to reverse this progress and increase taxes on hardworking Americans – all so that they can pay for more expensive, government-run programs.

As we recently heard from Congressional Budget Office Director, Dr. Keith Hall, these efforts are likely to have significant negative consequences for our economy and the constituents we represent. All of us sitting on this dais today have a responsibility to get our fiscal house in order – and raising taxes that will stifle growth and investment is not the answer.

As I have said before, we don't have a revenue problem – in fact, quite the opposite. With the Tax Cuts and Jobs Act, federal revenues in Fiscal Year 19 are expected to increase by $186 billion. What we have is a spending problem – a fact many Democrats are choosing to ignore. Today, mandatory spending accounts for 70 percent of all federal spending.

Without taking into account proposals for massive, new trillion-dollar entitlement programs, mandatory spending is expected to increase to 78 percent of all federal spending by 2029.

I hope that our discussion today illuminates for my colleagues on the other side of the aisle that the Tax Cuts and Jobs Act is helping local business owners like Ms. Pol create more jobs, increase paychecks and create more economic opportunities for families.

And, that to truly address the fiscal challenges facing our nation today and future generations, we must tackle the core driver of our ballooning debt: out-of-control spending.

With that, Mr. Chairman, thank you and I yield back.

Chairman YARMUTH. I thank the gentleman. And in the interests of time, if any other members have opening statements, you may submit those statements in writing for the record.

[The information follows:]

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COMMITTEE ON THE BUDGET

HEARING:
IMPACT OF 2017 GOP TAX LAW ON THE BUDGET AND AMERICAN FAMILIES

FEBRUARY 27, 2019
10:00 A.M.
210 CANNON



- Thank you Chairman Yarmuth for convening this important hearing to review and assess the negative impacts of the 2017 GOP TaxScam and discuss ideal revenue and budgetary policies that should be pursued going forward.

- Let me also welcome our witness and thank them for the helpful testimony:
  1. Professor Caroline Bruckner, Kogod School of Business, American University
  2. William G. Gale, Chair in Federal Economic Policy, Brookings; Co-Director, Urban-Brookings Tax Policy Center
  3. Chye-Ching Huang, Director of Federal Fiscal Policy, Center on Budget and Policy Priorities
  4. *Lana Pol, President of Geetings Inc., G.I. Warehouse Corp., Mowbility Sales & Service LLC, and Creative Inspirations LLC*

- Mr. Chairman, the GOP TaxScam was the wrong policy at the wrong time because it showered benefits on the top 1% and large multinational corporations while doing little for everyday working Americans and Main Street small business owners.

- GOP TaxScam also raises the nation's debt by $1.9 trillion at a time when the economy was already strong, and when we are facing major long-term budgetary challenges driven by our aging population.

- And rather than devoting resources to wise investments in our workers and small businesses, the GOP TaxScam further burdens working families, endangers Americans' retirement security, and worsens our budgetary outlook.

- Mr. Chairman, the verdict is in and none of GOP TaxScam's promises have borne out.

- Our long-term economic growth trajectory is unchanged and there is no sign of an investment boom.

- Real wage growth for workers remains modest and factories and jobs are more likely to go overseas.

- The federal deficit is soaring as corporate tax receipts plummet and the tax code is riddled with even more special-interest tax breaks and loopholes.

THE GOP TAXSCAM LED TO A RECORD-SETTING $1 TRILLION IN STOCK BUYBACKS.

- The GOP TaxScam delivered huge benefits to rich investors and CEOs through record-setting stock buybacks in 2018 while average workers struggle to pay for rising health care and living costs.

- Stock buybacks do nothing to improve business operations or help workers.

THE GOP TAXSCAM SHOWERS BENEFITS ON THE WEALTHY AND LARGE CORPORATIONS WHILE DOING LITTLE FOR WORKERS AND MAIN STREET SMALL BUSINESSES.

- The GOP tax cut is heavily tilted toward the wealthy and corporations and exacerbates the stagnation of wages for the vast majority of workers and worsens income and wealth inequality.

- The GOP tax law does nothing to help small businesses gain access to capital and grow their receipts.

- Only 5 percent of small businesses pay taxes at the corporate level and most of the pass-through tax cuts go to the largest 2.6 percent of businesses.

THE GOP TAX LAW ENCOURAGES COMPANIES TO SEND FACTORIES AND JOBS OVERSEAS:

- Under the GOP tax law, income generated by American companies abroad face tax rates that are half the new top corporate rate of 21 percent.

- Some companies may be able to avoid tax altogether on tangible investments made offshore.

- This further incentivizes companies to move tangible assets, such as factories and machinery, overseas.

- Rather than protecting workers and their families, the GOP tax law tilts the playing field against American workers.

THE GOP TAX LAW INCREASES DEFICITS BY $1.9 TRILLION WHEN WE ARE FACING MAJOR BUDGETARY CHALLENGES DRIVEN BY OUR AGING POPULATION.

- Even after accounting for any economic growth effects, the Congressional Budget Office (CBO) estimates the GOP tax scam increases deficits by $1.9 trillion over the ten years 2018 to 2028 – hardly the "pay for itself" message we heard from the Administration and Republicans in Congress.

- Yet the nation is facing long-term fiscal challenges that require more revenues to finance critical national needs.

- Projected spending increases over the next few decades are largely driven by our aging population.

- We need fair, progressive, and fiscally responsible revenue and budgetary policies.

- We need to make wise long-term investments in our workers and Main Street small businesses.

- We also need fiscally responsible tax and budgetary polices that return us to a sustainable fiscal trajectory.

- The GOP tax law does exactly the opposite by driving revenues to historically low levels and endangering Americans' retirement security and access to health care.

- Our friends across the aisle continue to claim that the GOP TaxScam significantly boosted economic growth, spurred an investment boom, drove unemployment down to the lowest level since the 1960s, created jobs for millions of workers, and helped middle-class families keep more of their paychecks.

- **These claims collapse in the crucible of actual experience.**

THE GOP TAXSCAM DID NOT SIGNIFICANTLY BOOSTS THE ECONOMY.

- While the law spurred a temporary 3.1 percent increase in real GDP last year, CBO expects growth to slow to 2.3 percent this year and 1.7 percent next year.

- By 2023, the tax law's positive effect on economic growth will fade away entirely.

THE GOP TAXSCAM DOES NOT SPUR BUSINESS INVESTMENT.

- There is no evidence of an investment boom, which Republicans promised would be the key to unleashing unprecedented economic growth and wage gains.

- Nonresidential business investment grew by less than 1 percent in the third quarter of last year, while business' orders for durable goods (another measure of investment) fell in December for the fourth time in five months.

- Instead of encouraging investment, the tax cut triggered a record level of stock buybacks.

GOP TAXSCAM NOT CAUSE OF LOWEST UNEMPLOYMENT SINCE 1968.

- President Trump is coasting on an economic expansion – now the second-longest on record – that began under President Obama.

- The law has not changed the unemployment trend.

- The unemployment rate has fallen steadily since the end of the Great Recession.

THE GOP TAXSCAM HAS NOT CREATED JOBS FOR MILLIONS OF WORKERS.

- More jobs were created in President Obama's last two years in office than President Trump's first two years.

- The law has not changed job creation trends.

- The tax law also encourages companies to send factories and jobs overseas rather than protecting jobs at home.

THE GOP TAXSCAM IS NOT HELPING MIDDLE-CLASS FAMILIES KEEP MORE OF THEIR PAYCHECKS.

- There has been very little increase in private sector compensation or wages since the tax law passed.

- Real wage growth continues to be disappointingly modest, and real bonuses increased by just 2 cents per hour between December 2017 and September 2018.

- The law ignores the stagnation of working-class wages and worsens income and wealth inequality.

- In fact, only 35 percent of the tax law's benefits in 2018 will go to the bottom 80 percent of households making less than approximately $150,000 per year.

EVEN THOUGH FEDERAL REVENUES HAVE RISEN, THE GOP TAXSCAM HAS CREATED A MAJOR REVENUE DEFICIENCY PROBLEM.

- Corporate tax receipts dropped an astounding 31 percent drop in 2018, with total receipts as a share of GDP falling to the lowest levels since the end of the Great Recession despite healthy economic growth and a tight labor market.

- Revenue last year was 16.4 percent of the economy, almost two percentage points below the 50-year average of 18.3 percent in years in which unemployment fell below 5 percent.

- By contrast, spending as a share of GDP last year fell right at the historical average.

- Major drivers of rising spending are primarily the result of demographics.

- To put it simply, Congress must make wise decisions to manage our budgetary challenges, not give deficit-financed tax cuts to the wealthy and attack Social Security, Medicare, and other crucial programs working Americans rely on.

- Thank you, I yield back my time.

Opening Statement Regarding a successful TX-21 business – McCoy's:

"I am excited to begin my time in this hearing today highlighting a real life, real America business success story. Not something from an economic model or a think-tank, but something from San Marcos, Texas.

McCoy's Building Supply is a family-run company for four generations, employing over 2500 individuals in five states. When speaking with the company earlier in the week, something that stood out was the direct impact of the booming economy on their business success. As a spokesperson noted, 'we don't live in a theoretical, academic bubble. We are convinced that changes to the tax law increased our sales in what we call the McCoy States of America'. Because of economic growth, the company had revenues that allowed it to invest in updating its facilities and improving its services for its customers – the what they call Alpha to Omega of residential and multi-family builders, remodelers, and contractors.

Increased revenues for Americans, not the government – that is what we should be about in Washington. And with that, I want to thank Ms. Pol for being here today and use the remainder of my time to do a little data-point checking with the rest of y'all."

Chairman YARMUTH. Now we will begin our testimony from the witnesses.

I first yield five minutes to Dr. Gale.

STATEMENTS OF WILLIAM G. GALE, Ph.D., ARJAY AND FRANCES FEARING MILLER CHAIR IN FEDERAL ECONOMIC POLICY, BROOKINGS INSTITUTION, CO-DIRECTOR OF TAX POLICY CENTER; CHYE-CHING HUANG, DIRECTOR OF FEDERAL FISCAL POLICY, CENTER ON BUDGET AND POLICY PRIORITIES; CAROLINE BRUCKNER, EXECUTIVE IN RESIDENCE, DEPARTMENT OF ACCOUNTING AND TAXATION, AMERICAN UNIVERSITY; AND LANA POL, PRESIDENT, GEETINGS, INC.

STATEMENT OF WILLIAM G. GALE

Mr. GALE. Chairman Yarmuth, Ranking Member Womack, members of the committee, thank you for inviting me to testify this morning. As was mentioned, I am affiliated with the Brookings Institution and the Tax Policy Center. My statements today represent my own views, not those of any institution.

The 2017 tax cut was the biggest overhaul since 1986. It definitely made some needed changes to the tax system. But my overall assessment, based on my own research and that of others, is that, on the whole, the tax cut was the wrong thing at the wrong time. Why was it the wrong thing? Good policy generally meets three tests. First is a growth test, it makes the economy stronger. Second is a fairness test, it makes the economy more fair. And third is a fiscal test, it is fiscally sustainable. TCJA does not pass any of those tests and it clearly fails two of them.

Let's start with the growth effect. That is the one that it does not pass. The Congressional Budget Office has indicated that national income after 10 years will go up by 0.1 percent because of the tax cut. That is a gross income number. If you looked at net income, it would actually be zero or lower. So it clearly does not pass the growth test.

Let's look at the fairness test. The tax cut increases disparities in after-tax income. It gives the largest absolute and relative tax cuts to high-income households. So on that ground alone, it fails the fairness test. But it is actually worse than that. If you consider that the tax cut has to be financed in some way, Representative Womack mentioned the long-term fiscal issue, if you consider that the tax cut has to be financed some way and you consider reasonable ways to finance the tax cut, you will find that most households will actually be worse off with the tax cut plus the financing than they would have been without the tax cut. So, it fails the fiscal test—I'm sorry, it fails the fairness test.

The third test is the fiscal test and the tax cut clearly makes the government's already difficult long-term fiscal status even worse. I do not want to waste your time and I do not want to insult anyone's intelligence. But it is important to state the tax cut did not pay for itself, it will not pay for itself. You can look at the analysis of any reputable organization, including the CBO, including the Tax Policy Center, including the Tax Foundation and you will find that that is the case. So it fails the fiscal test as well.

All right. The combination of not passing the growth test and failing the fairness test and failing the fiscal test means that what the tax cut will actually do is give more money to current generations of high-income households. And that will come at the expense of low- and middle-income households and of members of future generations. At the very least, I think we could agree that is not a model for what good public policy ought to do.

There are other issues as well that make TCJA the wrong thing. It made tax policy more complicated, it increased uncertainty, it will reduce health insurance coverage, it will raise the cost of health insurance, it will likely reduce contributions to charitable causes. Again, these are not hallmarks of good public policy.

So those are the reasons why I think it was the wrong thing. Why was it at the wrong time? Well, it was enacted at a time when the economy was already going strong. We had been expanding for eight years at that point, unemployment was low. It was a prime time to deal with the fiscal situation. As President Kennedy said, the time to fix the roof is when the sun is shining. We had an opportune chance to address the fiscal situation while the economy was strong and instead, we squandered that, making the deficit larger and giving tax cuts to high-income households.

You should also be aware that the 2017 tax cut will make it harder for policymakers to fight future recessions. It reduces the ability of the tax system to cushion the effects of the recession. It reduces the automatic stabilizer function of the tax system.

In terms of what you should do in response to these issues, I will just touch on three issues. One is to fix the issues in TCJA. A second is to give the IRS more resources to be able to do its job. And a third is to start thinking about longer-term revenue needs. Even if we do make judicious cuts in spending, the laws of arithmetic dictate that we will need to raise revenues and a value-added tax and particularly a carbon tax are the best options in that regard.

I thank you very much for inviting me and I look forward to talking about all of these issues.

[The prepared statement of William G. Gale follows:]

The 2017 Tax Law: Impact on the Budget and American Families

Testimony Submitted to
U.S. House of Representatives
Committee on the Budget

February 27, 2019

William G. Gale[1]
Brookings Institution
Tax Policy Center

Chairman Yarmuth, Ranking Member Womack, and Members of the Committee:

Thank you for inviting me to testify this morning on the 2017 tax law (Public Law 115-97), commonly known as the "Tax Cuts and Jobs Act" (TCJA). The law represents the biggest tax overhaul since 1986. It has had, and will continue to have, important effects on the economy.

My testimony, based on my own research and that of others, focuses on several key conclusions. Although it improved the tax code in some ways, TCJA (a) will have minimal impact on long-term growth; (b) increases disparities in after-tax income by giving the largest relative and absolute tax cuts to high-income households; (c) will make most households worse off after taking into account plausible ways of financing the tax cut; (d) makes the government's troublesome long-term fiscal status even worse; (e) makes the tax system more complex and more uncertain; (f) will make it harder for policymakers to fight future recessions; and (g) will reduce health insurance coverage, raise health insurance prices, and reduce charitable giving.

In combination, the law's small growth impact, regressive distributional effect, and negative fiscal impact imply that TCJA made the current generation of high-income households better off at the expense of lower-income households and future generations.

For all these reasons, policymakers should revisit the tax law and address the problems associated with it, as well as turn to longer-run considerations in tax policy.

The remainder of this testimony elaborates on these conclusions and related points. I also attach several articles that I have written that document these points in more detail.

- **TCJA will have minimal effects on long-term growth.**

[1] Arjay and Frances Fearing Miller Chair, The Brookings Institution, and Co-Director, Urban-Brookings Tax Policy Center. The views presented are my own and should not be taken to represent the views of the Brookings Institution or the Urban-Brookings Tax Policy Center.

Tax cuts may raise long-term growth by improving incentives to work, save, and invest, but the deficits they create will offset some or all of those gains. Most studies indicate that the long-term impact of TCJA on Gross Domestic Product (GDP) – the output produced in the United States – will be modest. The impact on Gross National Product (GNP) – the income that Americans receive – will be even smaller. Because the TCJA will encourage foreigners to invest in the United States, the returns they receive will reduce the share of income that Americans will keep from their production. For example, the Congressional Budget Office (CBO) estimated that TCJA will raise GDP by 0.5 percent by 2028, but about 80 percent of that increase will accrue to foreigners, leaving only an increase of 0.1 percent in national income (GNP). Once depreciation is taken into account, the remaining value – net national product – is essentially unchanged. As a result, CBO estimates imply that Americans will receive no increase in net income in 2028 from TCJA as written.

- **TCJA may have stimulated the economy over its first year, but other factors also clearly played an important role in recent economic performance.**

Almost any tax cut will boost the economy in the short run because higher after-tax incomes increase spending and investment and, thus, overall demand for US goods and services. But any boost to the economy in the short-run tells us little about the long-term effects. Indeed, the same economic models that predict that TCJA would have minimal long-term effects on growth also predict that it would have positive short-term effects. The long-term effects depend on supply-side factors, not the demand-side effects that boost short-term growth. The TCJA could spur saving and investment by increasing after-tax rates of return, but the rise in deficits created by TCJA (see below) will eventually raise the cost of capital for US businesses dampen or eliminate those supply-side effects.

And it is important to recognize the role of other factors in current economic performance. First, the economy had been growing for eight straight years before TCJA was enacted, and it was expected to continue to grow steadily even in the absence of TCJA. Second, a significant amount of the economy's recent uptick can be attributed to the higher government spending that was enacted as part of the 2018 budget deal and to recent rises in oil prices. (The U.S. used to a net importer of oil, which caused oil price increases to hurt the economy. Now, though, due primarily to "fracking," the U.S. has become a major exporter of oil and gas, so that higher prices encourage U.S. investment through increased rig construction and drilling activity.)

Thus, it is not evident that TCJA has had big effects in the short-term and, even if it did, that result is not indicative of the long-term results.

- **TCJA is providing disproportionately large benefits to high-income households.**

TCJA gave most of its benefits to the wealthy and thus increased the inequality of income, which had already been growing for the past four decades. Tax Policy Center (TPC) estimates show that TCJA increased after-tax income in 2018 by 0.4 percent for households in the lowest quintile, compared with 2.9 percent for those in the top quintile, and even more for the top few percent of households.

- **Taking into account plausible methods of financing the tax cut, most households will end up worse off under TCJA than if it had not been enacted.**

About 80 percent of taxpayers received a direct tax cut from TCJA, but that is not the end of the story. Tax cuts eventually have to be paid for. When President Trump said he was giving Americans a tax cut for Christmas, for example, he neglected to add that they (or their children) eventually would receive the bill. It is unclear how TCJA will eventually be financed, but in the most likely scenarios – where tax increases or spending cuts are imposed very broadly – for example, on an equal-per-household basis or and equal-share-of-income basis – most households will end up worse off than had the TCJA never passed.

- **TCJA makes a troublesome federal fiscal situation even worse.**

At the risk of stating the obvious, TCJA reduces revenues. It does not pay for itself. It does not come close to paying for itself. Revenues fell by 0.8 percent in 2018, even though the economy was growing. Corporate revenues plummeted.

The CBO estimates that TCJA will increase deficits by almost $1.9 trillion through 2028, even after incorporating the positive impact of the new law on the economy. If lawmakers make the temporary provisions of TCJA permanent, the long-term effects will be even more dire.

The Congressional Budget Office and my own research with Alan Auerbach and Aaron Krupkin show that the nation was poised for persistent and rising federal budget deficits and government debt even before TCJA was enacted. TCJA exacerbated this problem.

- **The combination of the minimal growth impact, the regressive distributional impact, and the negative fiscal impact, all described above, imply that TCJA will redistribute resources to current high-income households at the expense of current lower-income households and future generations.**

- **Although the tax law simplified taxes in some ways, it also made the tax system more complex in significant ways and created significant uncertainty surrounding tax policy.**

The chief sources of increased complexity are the pass-through provisions (section 199A) and the rules regarding international transactions and income (GILTI, BEAT, and FDII). The pass-through provisions are notoriously complex and often seem arbitrary in how they define qualifying businesses. The international rules are enormously complex and create unintended interactions, which cause effective tax rates to vary widely across investments.

The increased complexity has boosted employment significantly at law and accounting firms that provide tax advice.

Some of the uncertainty and complexity arises because the legislation was poorly drafted. These complexities are due in part to the rushed manner in which Republican majorities pushed

TCJA through the Congress. The combination of new, complicated tax changes and a rushed legislative calendar is a predictable recipe for disaster.

TCJA raised uncertainty in several ways. First, the interpretation of many of the rules – particularly for international taxation – is still not clear. Second, almost all the individual income tax provisions expire by the end of 2025, even though TCJA advocates insist that they will be extended. Other nonstandard items – such as the phase-in of amortization for R&D and increases in the so-called GILTI tax – raise questions as to whether they will be enacted. All these factors suggest that revisiting the law in the near future would be timely.

- **The 2017 tax law will make it harder for policymakers to fight recessions.**

The U.S. tax system generally works to help stabilize the economy. Tax revenues tend to rise and fall by more than income does, serving as an automatic stabilizer that buffers recessions and moderates booms. The 2017 tax law reduces the ability of the tax system to serve as an automatic stabilizer. The chief culprits are reductions in marginal personal and corporate income tax rates, changes to rules regarding net operating losses, and changes to deductions for depreciation and interest. The cyclical properties of FDII will exacerbate these problems.

Congress passed the TCJA at a time when the United States had recovered from the Great Recession. Tax cuts are most useful when they stimulate the economy during times of recession. At a time of full employment and strong corporate profits, however, Congress should have increased taxes to address the long-term fiscal shortfall, not cut them.

- **The 2017 tax law will raise the cost of health insurance and reduce coverage and will likely reduce charitable contributions.**

By eliminating the tax on people who do not buy adequate health insurance, TCJA will reduce health insurance coverage and raise health insurance premiums. This happens because, without a penalty, healthy people are most likely to forgo health insurance, knowing that ACA guarantees access to insurance in the future if their health status deteriorates. The law's reductions in alcohol excise taxes, if they are passed through to consumers, will raise alcohol-related deaths and other costs.

The sharp reduction in the number of households who will be able to itemize deductions on their income tax will likely reduce charitable contributions, as will the reduction in the top individual and corporate tax rates.

- **It is time to revisit and reform the 2017 tax law and move on to additional matters in tax revenues.**

The section 199A provisions are clearly inequitable, complex, regressive, and arbitrary. By taxing certain forms of business income lower than other forms of business income and by taxing business income at lower rates than wage income, the rules create all sorts of wasteful incentives for tax sheltering. These provisions should be repealed (or let to expire).

This can and should be considered jointly with efforts to broaden the tax base and raise rates for high-income households, including taxing capital gains at death (or providing a carry over basis regime).

The international rules' complexity and unintended effects calls for a revisiting and revamping of the law.

The sheer regressivity of the estate tax changes calls for reconsideration of those changes as well as consideration to move to an inheritance tax, to tax capital gains at death and/or consider some form of wealth taxation.

There is no substitute for giving the IRS the additional resources, people, tools, and legal changes that it needs to help track down at least some of the more than $500 billion tax gap the country faces today. These are taxes that are owed but not paid. We have good data on where the evasion takes place – capital income in general and sole proprietorship income in particular, and various studies show that each dollar of spending on enforcement can raise $3-$4 or more in revenues, yet the IRS budget is tiny, its work force is shrinking, and audit rates are down. This situation needs to be corrected immediately and permanently.

Looking to longer-term revenue needs, the nation will clearly need more revenue in the future to address rising health care and social security costs, rising net interest costs, and the debt (even if judicious cuts to non-interest spending are made). The obvious candidates here would be to let the TCJA rate cuts and brackets expire, to enact a value-added-tax (on the order of 10 percent, with offsets for low-income household) or to enact a significant carbon tax (starting at $30-$40 per ton, rising with inflation, and with offsets for low-income households.).

Thank you again for inviting me. I look forward to addressing these issues with you.

Chairman YARMUTH. Thank you very much for your testimony. I just want to remind the panelists that all of your written statements have been submitted and received by the committee. They will be part of the formal record of the committee, so you don't have to worry about that.

And I now yield five minutes to Ms. Huang.

STATEMENT OF CHYE-CHING HUANG

Ms. HUANG. Chairman Yarmuth, Ranking Member Womack and distinguished members of the committee, thank you for the opportunity to testify today about how the 2017 tax law largely left behind low and moderate income Americans and, in many ways, even hurts them.

Since 1979, the real incomes of working-class Americans, that is the racially and geographically diverse set of people often defined as workers without a college degree, have been virtually stagnant. The lowest income 60 percent of Americans saw their share of the nation's household income fall while those at the top saw their share gain by roughly the same amount.

The 2017 tax law could have focused on helping those facing the steepest challenges in this economy but it largely left them behind. And here is a prime example. The law increased the maximum child tax credit from $1,000 to $2,000 per child. But it denied that full increase to millions of children in low-income working families. Eleven million children in the lowest income working families got either no increase in the credit or a token increase of just $1 to $75. Another 15 million children got an increase of more than $75 but much less—but less often much less than the full $1,000 per child increase.

Another example is the law's failure to expand the earned income tax credit, a provision that encourages work, lifts the living standards of millions of working families and helps children do better.

And here are six ways that the law may, in fact, hurt many low and moderate-income households. First, it puts workers' wages and workplace standards at risk through its 20 percent deduction for passthroughs. That is an incentive for firms to buy workers' services without employing them directly, such as through hiring them as independent contractors or through another firm. And workers hired in some of these ways tend to be paid less than when workers are employed directly.

Second, it retains and even creates new incentives to shift profits and investments offshore, risking workers' wages here in the U.S.

Third, the law will leave millions more people uninsured or facing higher premiums because it repealed the Affordable Care Act's requirement that most people enroll in health insurance or pay a penalty.

Fourth, it erodes the value of earned income tax credit. The law uses a slower measure of inflation to adjust tax brackets and other provisions each year. For working families, that means that the earned income tax credit grows more slowly over time. And by 2027, a family that has two children, earning $40,000 will see their federal earned income tax credit shrink by roughly $300.

Fifth, it ended the child tax credit for 1 million children who are overwhelmingly dreamers who were brought to the U.S. by their immigrant parents.

And sixth, it adds $1.9 trillion to deficits over 10 years. That raises the pressure on policymakers down the road to squeeze or cut critical economic security programs and investments that have widely shared benefits.

Overall, in 2025, households in the bottom 60 percent will receive average tax cuts worth 1 percent of their after-tax income. But that pales in comparison to the top 1 percent's tax cuts worth 3 percent of their much larger incomes, or about 60,000 each per year on average.

That skew of the tax law increases racial inequalities. Decades of policy choices have set up barriers for households of color so they are overrepresented at the bottom of the income distribution, while white households are overrepresented at the top. That means that white households in the top 1 percent get tax cuts worth more than the tax cuts for the bottom 60 percent of households of all races combined, ITEP and Prosperity Now estimate.

Other winners are the tax advisers and lobbyists who are calling this law a bonanza.

Looking ahead, policymakers consider new course and pursue true tax reform that in fact prioritizes people with low or modest incomes, raises revenue to meet national needs and strengthens the integrity of the tax code.

Thank you, and I look forward to addressing your questions.

[The prepared statement of Chye-Ching Huang follows:]

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Fundamentally Flawed 2017 Tax Law Largely Leaves Low- and Moderate-Income Americans Behind

Testimony of Chye-Ching Huang, Director of Federal Fiscal Policy, Before the House Budget Committee

Chairman Yarmuth, Ranking Member Womack, and distinguished members of the Committee, thank you for the opportunity to testify. I will first outline the fundamental flaws of the 2017 tax law:[1] 1) it ignores the stagnation of working-class wages and exacerbates inequality; 2) it weakens revenues when the nation needs to raise more; and 3) it encourages rampant tax avoidance and gaming that will undermine the integrity of tax code. I will then explain in more detail how the 2017 tax law largely left behind low- and moderate-income Americans — and in many ways hurts them. Finally, I explain how a restructuring of the law can fix these flaws.

The 2017 Tax Law's Three Fundamental Flaws Mean It Requires Fundamental Restructuring

1. It ignores the stagnation of working-class wages and exacerbates inequality.

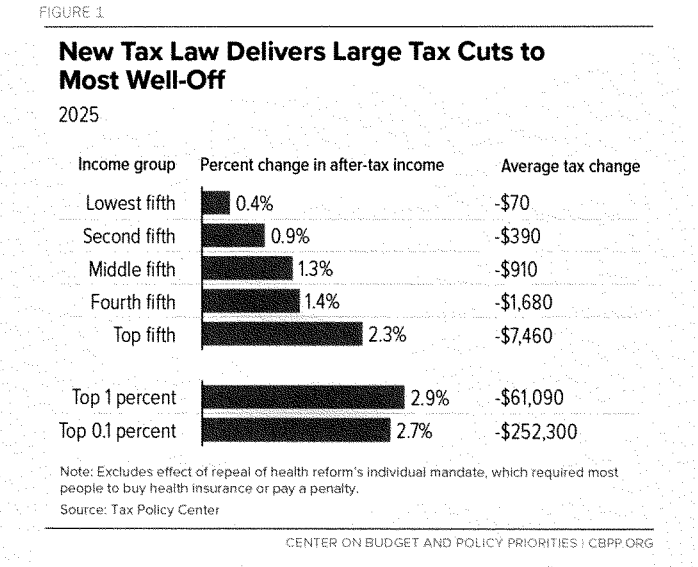
Instead of focusing on the challenges of low- and moderate-income people, the 2017 tax law will boost the after-tax incomes of households in the top 1 percent by 2.9 percent by 2025, roughly three times the 1.0 percent gain for households in the bottom 60 percent, the Tax Policy Center (TPC) estimates.[2] The tax cuts that year will average $61,100 for top 1 percent — and $252,300 for the top one-tenth of 1 percent. (See Figure 1.) The top 1 percent will already have after-tax incomes averaging $2.1 million that year, while the average incomes of the bottom 60 percent will be just $41,800.[3]

[1] The law's official name is "Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." It was originally titled the "Tax Cuts and Jobs Act" but that name was stricken from the bill. This testimony draws substantially on the following report: Chuck Marr, Brendan Duke, and Chye-Ching Huang, "New Tax Law Is Fundamentally Flawed and Will Require Basic Restructuring," CBPP, updated August 14, 2018, https://www.cbpp.org/research/federal-tax/new-tax-law-is-fundamentally-flawed-and-will-require-basic-restructuring.

[2] TPC Table T17-0314. 2025 is when the law will be fully phased in and is before many provisions in it are scheduled to expire. The distribution is roughly similar in Tax Policy Center tables for 2018. The law is even more tilted to the top in 2027, when most of the individual provisions expire.

[3] TPC estimates that in 2025, the top 1 percent will have after-tax incomes exceeding $837,800, and the bottom 60% will have incomes below $91,700.

FIGURE 1



The tax law's tilt to the most well-off exacerbates racial inequities. Decades of policy choices put barriers to economic success in front of households of color, resulting in those households being overrepresented on the bottom rungs of the income ladder, while white households are overrepresented at the top. White families are three times more likely than Latino and Black families to be among the highest-income 1 percent of households. So, while the highest-income white households make up just 0.8 percent of all households, they receive 23.7 percent of the total tax cuts from the 2017 tax law, far more than the 13.8 percent that the bottom *60 percent* of households of all races receives, the Institute for Taxation and Economic Policy estimates.[4]

The law's tilt to the top reflects several large provisions that primarily benefit the most well-off:

- **Cutting corporate taxes.** The 2017 tax law cuts the corporate tax rate from 35 to 21 percent and shifts toward a territorial tax system, in which multinational corporations' foreign profits largely no longer face U.S. tax. These tax cuts overwhelmingly benefit wealthy shareholders and highly paid executives. One-third of the benefits from cutting corporate rates ultimately

[4] Roderick Taylor, "ITEP-Prosperity Now: 2017 Tax Law Gives White Households in Top 1% More Than All Races in Bottom 60%," CBPP, October 11, 2018, https://www.cbpp.org/blog/itep-prosperity-now-2017-tax-law-gives-white-households-in-top-1-more-than-all-races-in-bottom.

flow to the top 1 percent, TPC estimates — assuming that the cost of those tax cuts are ultimately paid for, but without incorporating estimates of who ends up paying.[5]

- **A 20 percent deduction for pass-through income.** The law effectively cuts the marginal individual tax rate on pass-through income (income from businesses such as partnerships, S corporations, and sole proprietorships that business owners claim on their individual tax returns) by one-fifth. The top 1 percent of households will get 61 percent of this tax cut on pass-through income in 2024, while the bottom two-thirds of households will see just 4 percent, according to JCT.[6]
- **Doubling the estate tax exemption.** The law doubles the amount that the wealthiest households can pass on tax-free to their heirs, from $11 million per couple to $22 million, or many times the lifetime earnings of a typical high school graduate. The few estates large enough to remain taxable — fewer than 1 in 1,000 estates nationwide — will receive a tax cut of $4.4 million per couple.
- **Cutting individual income tax rates for those at the top.** The law cuts the top individual income tax rate from 39.6 percent to 37 percent for married couples with over $600,000 in taxable income. By itself, this will give a couple with $2 million in taxable income a $36,400 tax cut. The law also weakens the Alternative Minimum Tax, which is designed to ensure that higher-income people who take large amounts of deductions and other tax breaks pay at least a minimum level of tax. The law raises both the amount of income that's exempt from the AMT and the income level above which this exemption begins phasing out, delivering another tax cut to affluent households.

History, empirical evidence, and how real wages have fared since December 2017 are all reasons to doubt any claims that the large, immediate tax cuts for high-income filers benefit will eventually trickle down to low- and moderate-income households.[7] Instead, the economic circumstances of low- and moderate-income people were largely an afterthought in the law, and the law contains many provisions that will *harm* many such households. I will return to this issue after briefly outlining the tax law's two other major flaws.

2. It weakens revenues at a time when the nation needs to raise more.

The new tax law will cost $1.9 trillion over the next decade, JCT estimates. These large revenue losses are irresponsible given the fiscal challenges the nation will face over the next several decades. These challenges include the retirement of the baby boomers, health care costs that likely will continue to rise faster than the economy, interest rates returning to more normal levels, potential

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[5] 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.

[6] See Chuck Marr, "JCT Highlights Pass-Through Deduction's Tilt Toward the Top," CBPP, April 24, 2018, https://www.cbpp.org/blog/jct-highlights-pass-through-deductions-tilt-toward-the-top.

[7] Chye-Ching Huang, "Tax Cuts Must Be Judged by Their Effect on Typical Households," CBPP, April 25, 2018, https://www.cbpp.org/blog/tax-cuts-must-be-judged-by-their-effect-on-typical-households; "Large Job Growth Unlikely to Follow Tax Cuts for the Rich and Corporations," CBPP, October 10, 2017, https://www.cbpp.org/research/federal-tax/large-job-growth-unlikely-to-follow-tax-cuts-for-the-rich-and-corporations.

national security threats, and current and emerging domestic challenges such as large infrastructure needs that cannot be indefinitely deferred.

Because of these pressures, CBPP and other analysts project that spending will need to rise as a percentage of gross domestic product (GDP), with most of the spending growth concentrated in a few programs — Social Security, Medicare, and Medicaid — that have widespread public support and whose growth is traceable to demographic and health care cost factors, not to more generous coverage or benefits.[8] But the tax law went in the opposite direction, reducing revenues to a share of GDP to its lowest level in the last 50 years outside of the immediate aftermath of a recession.[9]

3. It encourages rampant tax gaming and risks undermining the integrity of tax code.

True tax reform simplifies the tax code and narrows the gaps between how different types of income are taxed. The 2017 tax law does the opposite, adding complexity to the tax code and introducing new, arbitrary distinctions between different kinds of income. This means that the law has created lucrative new opportunities for the well-advised to try to game the tax code to avoid taxes — including by lobbying to keep the regulations to implement the hastily enacted law as favorable for them as possible. Tax advisors and lobbyists are referring to the law as a "bonanza" and a "giant present to the tax lobbying community."[10]

The creation and widespread abuse of tax shelters could cause the bill to lose even more revenue than current estimates of the law now show — and is likely to increase income inequality even more, since tax avoidance is worth the most to wealthy individuals and profitable corporations, who also are best equipped to take advantage of those opportunities.

Examples of potential sheltering opportunities created by the 2017 tax law include:

- **The law's 20 percent deduction for "pass-through" income.** The deduction effectively means that certain pass-through income will face a lower tax rate than wages and salaries, creating an incentive for high-income individuals to reclassify their salaries as pass-through income. While the law has complex "guardrails" to try to prevent such abuse, they are poorly designed, and invite gaming by tax advisors. For reasons such as this, NYU law professor Daniel Shaviro's has aptly described the pass-through provision as "the worst provision ever even to be seriously proposed in the history of the federal income tax."[11]

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[8] For more, see: Paul Van de Water, "2017 Tax Law Heightens Need for More Revenues," CBPP, November 15, 2018, https://www.cbpp.org/research/federal-tax/2017-tax-law-heightens-need-for-more-revenues.

[9] Dylan Matthews, "Obama's chief economist: Trump's economic projections are 'the most absurd I've ever seen,'" Vox, February 19, 2018, https://www.vox.com/policy-and-politics/2018/2/19/17012288/trump-budget-proposal-obama-chief-economist-jason-furman-interview.

[10] Theodoric Meyer, "It's a giant present to the tax lobbying community: K street lobbyists are banking on years of paydays from the tax overhaul," *Politico*, January 2, 2018, https://www.politico.com/story/2018/01/02/tax-overhaul-paydays-for-k-street-261668.

[11] Daniel Shaviro, "Apparently income isn't just income any more," Start Making Sense, December 16, 2017, http://danshaviro.blogspot.com/2017/12/apparently-income-isnt-just-income-any.html.

The final regulations implementing the deduction have been shaped by heavy industry lobbying.[12] And the provision presents a boon for tax advisors, with one financial advisor telling a conference of such advisors:[13]

> This is, without a doubt, one of the biggest areas of planning that we can have under the new law. This is why, in large part, they should have just renamed the [2017 tax law] the tax professional, lawyer and financial advisor job security act of 2017.
>
> The [pass-through] deduction leaves a gaping hole in the tax code, and the goal by the end of the presentation today is to make you guys the bus drivers, or the truck drivers, to drive right through that hole with your clients.

- **A powerful incentive for wealthy Americans to shelter large amounts of income in corporations.** The law creates a powerful incentive for wealthy Americans to shelter large amounts of income in corporations by slashing the corporate rate to 21 percent, far below the top individual tax rate of 40.8 percent (the new 37 percent top individual income tax rate plus the 3.8 percent Medicare payroll or net investment income tax rate). This will entice wealthy people to shield their labor or interest income from the top individual rate by setting up a corporation and reclassifying their income as corporate profits in order to pay the lower corporate rate.

These new tax avoidance opportunities threaten the integrity of the tax system, particularly coming when the IRS enforcement budget has been drained by *25 percent* in real terms since 2010.[14]

Law Does Relatively Little for Low- and Moderate-Income Americans — and Hurts Many

I have just outlined the three fundamental flaws of the 2017 tax law. Let me now examine in more detail how the 2017 tax largely leaves behind low- and moderate-income Americans — and indeed hurts many.

The 2017 tax law should have placed top priority on raising the living standards of low- and moderate-income households, given decades of stagnant working-class incomes and growing income inequality. The share after-tax income flowing to the bottom 60 percent fell by 3.8 percentage points between 1979 and 2015, while the share flowing to the top 1 percent rose by 5.6 percentage points.[15]

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[12] Samantha Jacoby, "Pass-Through Deduction Regulations Reflect Industry Lobbying," CBPP, January 30, 2019, https://www.cbpp.org/blog/pass-through-deduction-regulations-reflect-industry-lobbying.

[13] Emily Horton, "Tax Planner: Drive Wealthy Clients Through 'Gaping Hole' in Tax Code," CBPP, May 31, 2018, https://www.cbpp.org/blog/tax-planner-drive-wealthy-clients-through-gaping-hole-in-tax-code.

[14] Roderick Taylor, "House Bill Leaves IRS Enforcement Depleted," CBPP, May 24, 2018, https://www.cbpp.org/blog/house-bill-leaves-irs-enforcement-depleted. This blog post was written based on the House Appropriation Committee's 2019 funding bill, but the enforcement figure of 25 percent remains the same in the final appropriations bill as well.

[15] The share of income going to the top 1 percent increased from 7.4 to 13.0 percent, while the share going to the bottom 60 percent fell from 36.3 to 32.5 percent. See: Congressional Budget Office, "The Distribution of Household Income, 2015," November 8, 2018, https://www.cbo.gov/publication/54646. Income shares have been recalculated to exclude households with negative income.

And looking at the "working class" — a racially and geographically diverse group often defined as families with working-age adults in which no one has a college degree — real working-class median income rose by only about 3 percent from 1979 to 2015.[16]

2017 Tax Law Largely Left Behind Low- and Moderate-Income People

The drafters of the 2017 tax law ignored key tools they could have used to raise living standards for low- and moderate-income people. The Child Tax Credit (CTC) and Earned Income Tax Credit (EITC) are provisions of the tax code that lift the living standards of millions of working families. A growing body of evidence also links income from these tax credits to better infant health, improved school performance, higher college enrollment, and projected increases in earnings in adulthood for children in families that receive them.[17] The 2017 tax law could have substantially helped low- and moderate-income households by boosting these tax credits in ways that would benefit them, but instead it:

1. Increased the CTC in a way that largely left behind millions of working families, while doing much more for high-income families.[18]

The law increased the maximum CTC from $1,000 to $2,000 per child — but denied that full increase to millions of children in low-income working families.

- **11 million children in low-income working families will receive just a token CTC increase of just $1 to $75.** Before the 2017 tax law, the CTC was a maximum tax credit of $1,000 per eligible child under age 17. However, many low- and moderate-income working families could not receive the maximum credit — so increases to the maximum do nothing to help them. That's because working families with children under 17 with incomes too low to owe much or any income tax could get only part of the CTC as a tax refund. Before the 2017 tax law, that refundable amount was limited to 15 percent of a family's earnings over $3,000. The 2017 tax law lowered the threshold so that earnings over $2,500 would count towards earning a CTC. This translates to a CTC increase of just $75 (15 percent of $500) for those families — such as a single mother with two children who works full time at the federal minimum wage and earns $14,500 a year. (See Figure 2.)
- **Another 15 million children in low- and modest-income working families get a CTC increase of more than $75 — but often far less — than the full $1,000-per-child increase.** That's because the 2017 law introduced a new cap on the refundable amount of the credit, at $1,400 per child (indexed for inflation), meaning that for millions of children in moderate-income working families their CTC increase was limited to no more than $400 per

[16] Chuck Marr, Brandon DeBot, and Emily Horton, "How Tax Reform Can Raise Working-Class Incomes," CBPP, October 13, 2017, https://www.cbpp.org/research/federal-tax/how-tax-reform-can-raise-working-class-incomes.

[17] Chuck Marr *et al.*, "EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds," CBPP, updated October 1, 2015, https://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens.

[18] "2017 Tax Law's Child Credit: A Token or Less-Than-Full Increase for 26 Million Kids in Working Families," CBPP, August 27, 2018, https://www.cbpp.org/research/federal-tax/2017-tax-laws-child-credit-a-token-or-less-than-full-increase-for-26-million.

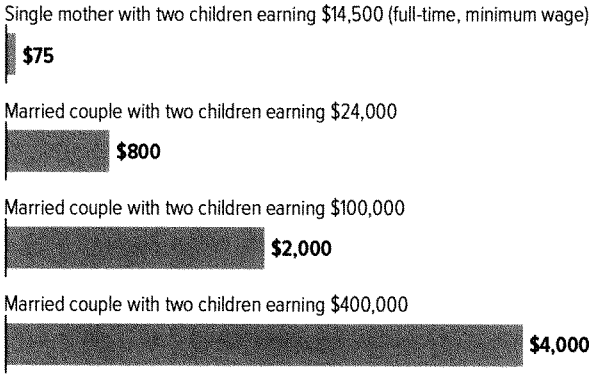
child. For example, a married couple with two children making $24,000 will get an $800 increase in their total CTC — well below the $2,000 maximum.

- **The largest CTC increases go to high-income families.** The credit now begins to phase out for married couples making $400,000 a year, compared to $110,000 under prior law. A married couple with two children making $400,000 are now newly eligible for a full $2,000-per-child CTC, a $4,000 increase.

FIGURE 2

Lowest-Income Families Largely Left Out of New Tax Law's Child Tax Credit Increase

Tax credit increase compared to previous law, 2018



Source: CBPP analysis

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This outcome was a deliberate choice by the law's drafters: negotiators agreed last-minute to a deeper cut in the top individual tax rate, but rejected calls to use that same funding source — a slight reduction in the law's cut in the corporate tax rate — to deliver more than a token CTC increase to 11 million children in low-income working families.

2. Ignored the Earned Income Tax Credit, a critical tool for boosting workers' incomes.

Stagnant working-class wages call for a strong policy response, and the EITC is well-designed to be at the forefront of addressing this challenge. It already lifts millions out of poverty and supplements the wages of a diverse group of working-class people who do needed jobs but receive relatively low pay, from truck drivers to cooks to home health aides.[19] And it can be strengthened to

[19] Jennifer Beltran, "Working-Family Tax Credits Lifted 8.9 Million People Out of Poverty in 2017," CBPP, January 15, 2019, https://www.cbpp.org/blog/working-family-tax-credits-lifted-89-million-people-out-of-poverty-in-2017.

do more. But, despite former Speaker Paul Ryan's purported commitment to strengthening the EITC,[20] no boost in the EITC was proposed or included in the 2017 tax law. Indeed, a provision of the law (discussed below) erodes the value of the EITC over time.

Provisions That Hurt Many Low- and Moderate-Income Households

In addition to failing to address the economic challenges that low- and moderate-income people face, the 2017 tax law included provisions that will hurt many such households. For example, it:

1. **Risks harming workers' wages and workplace standards due to its pass-through deduction.** The law's 20 percent deduction for pass-through businesses is overwhelmingly tilted to the highest-income filers. My colleagues have also explained that the deduction may fuel a move towards "fissured workplaces," because it creates an incentive for firms to buy workers' services without employing them directly.[21] Examples include hiring workers as "independent contractors" instead of as employees, or by hiring workers through another firm (such as contracting out janitorial services to another firm). Workers employed in some of these fissured workplace arrangements tend to be paid less than workers that firms employ directly, extensive evidence shows.

2. **Retains and creates incentives for companies to shift profits and investment offshore, which risks weakening workers' wages.** The law moves U.S. international tax system towards a "territorial" system, where most profits that a U.S. parent company earns from its foreign subsidiaries aren't subject to U.S. tax under certain conditions. That risks a big, permanent incentive for U.S. multinationals to shift overseas not just profits on paper, but also actual investment, in ways that could hurt U.S. workers' wages.[22] The law has several provisions to try to limit the damage this basic incentive could cause, but still leaves in place a large incentive to shift profits offshore.[23] Further, one of those anti-abuse measures — a new minimum tax on certain foreign income — is poorly designed and has its own incentives for companies to shift profits and investments overseas.

   Ironically, during the 2016 presidential campaign, then-candidate Donald Trump proposed to immediately tax profits made from overseas investments just like profits from domestic investments are taxed, which would have avoided these problems. But, President Trump dropped his proposal and joined congressional Republicans in pushing for a territorial system.

3. **Leaves millions more people uninsured or facing higher premiums.** The 2017 tax law repealed the Affordable Care Act's requirement that most people enroll in health insurance

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[20] Dylan Matthews, "Obama is testing Paul Ryan's commitment to fighting poverty, and Ryan is failing badly," *Vox*, December 2, 2014, https://www.vox.com/2014/12/2/7320363/eitc-child-credit-ryan.

[21] Brendan Duke, "2017 Tax Law's Pass-Through Deduction Could Encourage 'Workplace Fissuring,'" CBPP, December 20, 2018, https://www.cbpp.org/blog/2017-tax-laws-pass-through-deduction-could-encourage-workplace-fissuring.

[22] Jane Gravelle, "The Need for Comprehensive Tax Reform to Help American Companies Compete in The Global Market And Create Jobs for American Workers," House Ways and Means Committee hearing, May 12, 2011, https://www.gpo.gov/fdsys/pkg/CHRG-112hhrg70882/html/CHRG-112hhrg70882.htm.

[23] Kimberly Clausing, "Profit Shifting Before and After the Tax Cuts and Jobs Act," SSRN, October 29, 2018, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3274827.

coverage or pay a penalty. In 2019 alone, eliminating that penalty will raise the number of uninsured by 4 million and raise premiums in the individual insurance market by about 10 percent, according to the Congressional Budget Office (CBO).[24]

4. **Erodes the EITC for millions of working-class households**. The law uses a slower measure of inflation to adjust tax brackets and other tax provisions each year. Over time, this will raise taxes across the board. And for low- and moderate-income families, it means the maximum EITC will increase more slowly. By 2027, a married couple making $40,000 with two children will see their federal EITC shrink by $283 in 2027 (from $5,025 to $4,742).
5. **Ends the CTC for 1 million children — overwhelmingly "Dreamers."** The law ends the CTC for 1 million children lacking a Social Security number in low-income working families, who are overwhelmingly "Dreamers" with undocumented status brought to the United States by their immigrant parents.[25]
6. **Adds $1.9 trillion to deficits over 2018 to 2027, putting pressure on critical economic security programs and investments.**[26] As noted above, baby boomers are retiring, and the nation needs to address years of underinvestment in priorities like basic infrastructure, child care, job training, and to face new challenges like climate change. More revenues, not less, are needed to face of these challenges.

   Further, even before adding $1.9 trillion to deficits for tax cuts tilted to the top, the law's drafters made clear in their budget proposals and statements that their preferred way of addressing deficits would be to cut programs that help families of limited means afford health care, food, housing, and other basic needs.[27] For example, those budgets have consistently featured large cuts in Medicaid, which provides health and nursing home care to millions of these families. Low- and moderate-income Americans should not now be left holding the tab for tax cuts tilted to the top, through cuts to, or underinvestment in, critical priorities. Instead, lawmakers can reverse course and raise substantially higher progressive revenues to meet national challenges.

The Appendix provides for each state examples the impacts of the 2017 tax law that exemplify how it favors the most well-off instead of low- and moderate-income Americans.[28]

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[24] Tara Straw *et al.*, "Strong Demand Expected for Marketplace Open Enrollment, Despite Administration Actions," CBPP, October 31, 2018, https://www.cbpp.org/research/health/strong-demand-expected-for-marketplace-open-enrollment-despite-administration#_ftn11.

[25] Jacob Leibenluft, "Tax Bill Ends Child Tax Credit for About 1 Million Children," CBPP, December 18, 2017, https://www.cbpp.org/blog/tax-bill-ends-child-tax-credit-for-about-1-million-children.

[26] Proponents of the law such as Treasury Secretary Steven Mnuchin claim that the tax cuts will pay for themselves by increasing economic growth. Yet, estimates from CBO that take into account the law's macroeconomic impact as well as increase in interest payments on the added debt still put its 2018-2027 cost at $1.9 trillion.

[27] Robert Greenstein, "Commentary: With Tax Cuts for the Top, GOP Leaders Now Aim Budget Cuts at the Bottom," CBPP, December 21, 2017, https://www.cbpp.org/research/federal-tax/commentary-with-tax-cuts-for-the-top-gop-leaders-now-aim-budget-cuts-at-the.

[28] A more detailed, interactive version of this Appendix can be found at: https://www.cbpp.org/federal-tax/fundamentally-flawed-2017-tax-law-largely-leaves-low-and-moderate-income-americans#mapEmbed.

Conclusion

To undo the damage caused by the 2017 tax law and meet national needs, lawmakers can craft meaningful tax reform that eliminates various loopholes, shelters, and gaming opportunities the tax code now contains, raises much-needed revenue, and is more favorable to working households with low or modest incomes. In heading towards this goal, lawmakers can keep in mind that:

- **Only a basic restructuring of the 2017 tax law can fix its flaws, as they stem from the law's core provisions.** For example, the corporate rate cut and the 20 percent deduction for pass-through businesses contribute to all three of the measure's major flaws: they worsen inequality by disproportionately benefiting the well-off; they lose significant revenue at a time when demographic and other pressures require federal revenue to rise; and they will likely encourage significant tax avoidance by creating major incentives for wealthy individuals to recharacterize their income in search of lower taxes. Minor tinkering cannot solve these problems.
- **Improving the EITC and CTC should be top priorities of any restructuring effort.** Building on the success of these credits for workers and families is a sound way to raising the living standards of the low- and moderate-income Americans who were largely overlooked by the 2017 tax law, and who have faced decades of economic challenges.
    - As noted above, 15 million children in low-income working families received just a token CTC increase from the 2017 tax law, and 15 million children in low- and moderate-income working families were left out of the full increase. To fix these shortcomings and ensure that low- and moderate-income families are not left out, the CTC should be made fully refundable so that low- and moderate-income families receive the full $2,000-per-child credit. At the very least, the CTC should be set to phase in at the first dollar of earnings, at a higher rate, and without a $1,400 refundability cap.
    - In the EITC, a key priority should be fully extending the EITC's pro-work success to childless adults. In contrast to families with children, the EITC for workers not raising children in the home remains extremely small — too small even to fully offset federal taxes for workers at the poverty line. As a result, low-wage workers not raising children are the sole group that the federal tax system taxes into, or deeper into, poverty. After helping childless workers, policymakers should further expand the EITC for families with children since the credit is well placed to feature in efforts to boost working-class Americans' incomes. A substantial EITC improvement for these families would help mitigate decades of working-class income stagnation.
- **In the interim, any true "technical corrections" to fix drafting mistakes in the tax law cannot compound the flaws of the 2017 tax law itself — and should instead start to fix them**. For example, former Ways and Means Chairman Kevin Brady proposed last year a "technical corrections" package that would have helped restaurant and retail owners while doing nothing for millions of their workers. As my colleague has written, "To be sure, the authors of the 2017 tax law omitted full expensing for restaurant and retail business owners inadvertently, while omitting [...] CTC and EITC improvements for low-wage workers by design. But if ignoring these workers was a major mistake the first time, as it surely was, then

ignoring them again would compound the error."[29] As was the case in in 2018, no technical corrections package that delivers a valuable fix to business owners or other high-income filers should be passed unless the package *also* starts to make progress for the millions of children and workers who were left out or largely left out of improvements in tax credits for working families. This means starting to make down payments on the EITC and CTC changes mentioned above.

- **Any budget deal should include adequate funding of the IRS, and particularly for IRS enforcement.** IRS enforcement funding overall has been cut by 25 percent since 2010, after adjusting for inflation, and the enforcement division has lost roughly 30 percent of its workforce over that period. The cuts have driven a more than 40 percent decline in the rate of audits — especially for high-income individuals and large corporations. And enforcement needs have only grown as a result of the 2017 tax law.

  Not only is restoring IRS enforcement levels to adequate levels critical for the integrity of the tax code, it is also fiscally sound. CBO estimates that once staff training and computer upgrades are completed, each $1 of additional enforcement funding would generate $5.20 in additional revenue.[30] Moreover, the Treasury Department notes that this return on investment likely is understated because it includes only the amounts directly recovered; it does not reflect the effect that enhanced enforcement has on deterring non-compliance. This deterrence could triple the rate of return on each additional dollar invested in IRS enforcement, the Office of Management and Budget (OMB) has written.[31]

  When Congress negotiates a new budget agreement, it should include a Trump Administration proposal to improve the enforcement of the nation's tax laws by adding IRS enforcement funding that doesn't count against the annual cap on overall funding for non-defense appropriations. There is a lengthy bipartisan history of exempting from the cap certain types of program integrity funding — to reduce errors, overpayments, and fraud in government programs and taxes — that OMB estimates will produce net savings.[32] That approach to IRS enforcement funding is especially timely now, given the IRS enforcement division's depleted personnel and its coming workload increase under the 2017 tax law.

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[29] Chuck Marr, "House GOP Tax Fix for Restaurant, Retail Owners Leaves Out Millions of Their Workers," CBPP, December 6, 2018, https://www.cbpp.org/blog/house-gop-tax-fix-for-restaurant-retail-owners-leaves-out-millions-of-their-workers.

[30] Congressional Budget Office, "Options for Reducing the Deficit: 2019 to 2028," p. 307, December 13, 2018, https://www.cbo.gov/system/files?file=2018-12/54667-budgetoptions.pdf.

[31] Office of Management and Budget, FY17 President's Budget Appendix, p. 1047, https://obamawhitehouse.archives.gov/sites/default/files/omb/budget/fy2017/assets/tre.pdf.

[32] For OMB's calculation of the net savings derived from the proposed IRS cap adjustment, see Office of Management and Budget, see Office of Management and Budget, FY19 Analytical Perspectives Table 10-2, P.110, https://www.whitehouse.gov/wp-content/uploads/2018/02/ap_10_process-fy2019.pdf.

Appendix

TABLE 1

Effects of the 2017 Tax Law by State

	Number of children in working families receiving less than the full CTC increase, 2018	Average tax cut for top 1 percent, 2019	Average tax cut for bottom 60 percent, 2019	Number of estates wealthy enough to benefit from estate tax cut	Increase in individual market premiums for a family of four, 2019
Alabama	440,000	$49,660	-$370	40	$2,230
Alaska	54,000	$73,010	-$510	*	$2,900
Arizona	678,000	$54,250	-$410	90	$2,060
Arkansas	309,000	$42,220	-$410	30	$1,450
California	3,532,000	$26,890	-$580	1,230	N.A.
Colorado	374,000	$62,920	-$490	90	N.A.
Connecticut	182,000	$71,030	-$450	70	N.A.
Delaware	63,000	$40,780	-$470	*	$2,350
District of Columbia	37,000	$81,240	-$530	20	N.A.
Florida	1,658,000	$98,480	-$320	600	$1,860
Georgia	1,047,000	$64,620	-$370	100	$1,930
Hawaii	91,000	$39,420	-$470	30	$1,750
Idaho	159,000	$48,220	-$390	20	N.A.
Illinois	994,000	$58,750	-$540	190	$1,940
Indiana	572,000	$48,840	-$460	60	$1,360
Iowa	209,000	$43,060	-$490	40	$2,850
Kansas	238,000	$60,150	-$510	40	$2,070
Kentucky	386,000	$37,870	-$350	50	$1,690
Louisiana	464,000	$54,230	-$330	30	$1,900
Maine	78,000	$31,900	-$370	20	$2,350
Maryland	337,000	$52,360	-$460	100	N.A.
Massachusetts	317,000	$84,720	-$560	120	N.A.
Michigan	782,000	$57,700	-$430	100	$1,520
Minnesota	336,000	$42,700	-$520	80	N.A.
Mississippi	314,000	$35,970	-$310	20	$2,080
Missouri	483,000	$48,840	-$370	80	$2,120
Montana	79,000	$52,550	-$290	20	$2,100
Nebraska	152,000	$50,750	-$510	40	$3,070
Nevada	272,000	$104,700	-$500	60	$1,730
New Hampshire	56,000	$57,320	-$630	40	$1,900
New Jersey	549,000	$30,440	-$520	160	$1,650
New Mexico	240,000	$38,440	-$410	20	$1,660
New York	1,458,000	$29,890	-$390	420	N.A.
North Carolina	919,000	$44,760	-$360	130	$2,510
North Dakota	41,000	$60,280	-$440	*	$1,510

TABLE 1

Effects of the 2017 Tax Law by State

	Number of children in working families receiving less than the full CTC increase, 2018	Average tax cut for top 1 percent, 2019	Average tax cut for bottom 60 percent, 2019	Number of estates wealthy enough to benefit from estate tax cut	Increase in individual market premiums for a family of four, 2019
Ohio	924,000	$47,510	-$420	150	$1,480
Oklahoma	375,000	$49,950	-$320	30	$2,630
Oregon	314,000	$33,570	-$430	50	$1,650
Pennsylvania	825,000	$53,580	-$400	160	$2,300
Rhode Island	64,000	$43,400	-$410	20	N.A.
South Carolina	443,000	$48,520	-$380	40	$2,080
South Dakota	66,000	$88,650	-$440	20	$2,080
Tennessee	612,000	$56,820	-$410	70	$2,970
Texas	3,045,000	$80,350	-$460	310	$1,730
Utah	257,000	$68,960	-$540	*	$2,100
Vermont	32,000	$33,400	-$470	*	N.A.
Virginia	516,000	$60,440	-$420	140	$2,140
Washington	472,000	$90,480	-$600	80	N.A.
West Virginia	143,000	$28,120	-$240	30	$2,180
Wisconsin	391,000	$53,430	-$460	60	$2,270
Wyoming	36,000	$108,880	-$420	20	$3,460
Utah	440,000	$68,960	-$540	*	$2,100
Vermont	54,000	$33,400	-$470	*	N.A.
Virginia	678,000	$60,440	-$420	140	$2,140

Source: CBPP Child Tax Credit calculations, Institute for Taxation and Economic Policy analysis of the 2017 tax law, IRS estate tax tabulations, Center for America Progress analysis of repealing the Affordable Care Act's individual mandate. Shows children in families with earnings that are too low to receive the full CTC increase.

A more detailed interactive version of this Appendix can be found online at https://www.cbpp.org/federal-tax/fundamentally-flawed-2017-tax-law-largely-leaves-low-and-moderate-income-americans#mapEmbed.

Note: "*" for estate tax data means that it was deleted by the IRS to prevent disclosure of individual taxpayer information due to small number of estates. CAP premium data are not available for every state.

Chairman YARMUTH. Thank you very much for your testimony. I now recognize Ms. Bruckner for five minutes.

STATEMENT OF CAROLINE BRUCKNER

Ms. BRUCKNER. Thank you for inviting me and, by extension, the American University students who are here with us today. Today, I want to share with you how my research indicates the need for a comprehensive strategy to study how some of the business tax expenditures included in tax reform impact women business owners, 99 percent of whom are small businesses; how health care costs for small businesses have been impacted by tax reform; and, lastly, the need to consider the budget implications of tax reform's failure to address the tax compliance challenges of the gig economy.

First, this committee needs to develop a comprehensive strategy to study and give oversight to business tax expenditures to consider their impact and effectiveness with respect to women business owners. This research matters because 40 percent of U.S. businesses are women business owners, yet they remain primarily small businesses operating as service firms and continue to have challenges growing their receipts and accessing capital. Notably, women of color are the driving force behind the growth of women-owned firms. And while we do have good news on their growth in numbers, women business owners still struggle to access capital to grow and scale their businesses. At the same time, tax plays a key role in the survival and growth of small businesses, primarily through its effect on equity infusion. However, to date, there has been no formal government or congressional study on how the U.S. tax code's more than $303 billion of expenditures targeted to small businesses impact women-owned firms. This is troubling considering in 2017, I found—I published groundbreaking research that found that Congress has a billion-dollar blind spot when it comes to understanding how business expenditures help these firms. In fact, three of the four small business expenditures I studied either explicitly excluded service firms and, by extension, the majority of women-owned firms, or effectively bypassed women-owned firms who are not incorporated or who are service firms with few capital-intensive equipment investments altogether.

Congress doubled down on this billion-dollar blind spot during tax reform when it made additional multibillion-dollar investments in tax expenditures that our research suggests are less favorable to women business owners. For example, JCT's analysis of the new Section 199A deduction for individuals with business income shows that the majority, 90 percent, of the revenue distribution loss will flow to firms who have incomes greater than $100,000 of revenue. Eighty-eight percent of women business owners have revenues below $100,000. This inequitable distribution of the revenue loss is even greater and more stark at the higher income levels. Only 1.7 percent of women business owners have revenues over a million dollars, yet 44 percent of the revenue loss flows to those firms in this year alone.

A second concerning aspect of tax reform is its impact on health care costs for the smallest of small business owners, those self-employed workers who buy insurance on the private markets. However, as part of tax reform, Congress effectively repealed the indi-

vidual mandate, which CBO estimated would result in 4 million fewer people carrying insurance this year, another 13 million in 2027, and that premiums would increase by 10 percent in most years of the next decade. Recent evidence shows that CBO was correct. In fact 2019 premiums, according to at least one estimate, will be an average 6 percent higher as a direct result of the individual mandate repeal and the expansion of more loosely regulated plans than would otherwise be the case.

And it is not just an increase in premiums that are a cause of concern with respect to the impact of tax reform. The reported lower refunds taxpayers are receiving due to changes in withholding may have unintended yet painful consequences for taxpayers who anticipated a higher refund and put off health care spending until they got their refund. Banking research shows that Americans increase their out-of-pocket health care spending by 60 percent in the week after receiving a tax refund. For those taxpayers who are this year receiving lower refunds, they may have to wait even longer to pay for much needed health care costs.

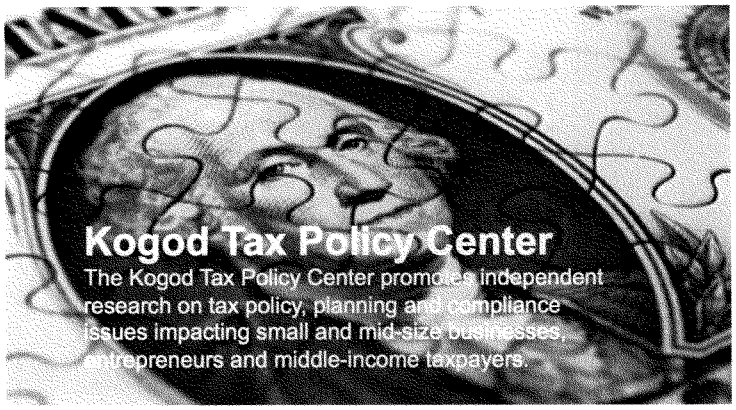
Finally, I am really concerned about how tax reform failed to address the tax compliance challenges of the 2.3 million Americans working in a side hustle in the gig economy. In 2016, I published research that shows that more than 60 percent of these workers do not get any tax information reporting forms, which means the IRS doesn't, either. Under current law, the platforms are not required to publish these forms to the workers or the IRS until those workers meet a $20,000, 200-transaction threshold. But the reality is, most folks with a side hustle in the gig economy never meet that $20,000 threshold and therefore are not getting the tax information reporting forms that they need to actually pay their taxes. This has dire consequences with respect to the budget, as well as their ability to fund their own Social Security contributions.

However, Congress was well aware of this issue and chose not to act in connection with tax reform. These are issues that Congress and this committee should be tracking and studying as it moves forward with its oversight of tax reform.

Thanks so much and I am happy to answer any questions that you have.

[The prepared statement of Caroline Bruckner follows:]

KOGOD SCHOOL *of* BUSINESS
AMERICAN UNIVERSITY • WASHINGTON, DC



2017 Tax Law – Impact on the Budget and American Families

Hearing of the United States House of Representatives Committee on the Budget

Wednesday, Feb. 27, 2019

Written Testimony of Professor Caroline Bruckner,
Executive-in-Residence, Accounting and Taxation
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Chair Yarmuth, Ranking Member Womack, Committee Members and Staff, thank you for the opportunity to testify today. My name is Caroline Bruckner and I am a tax professor on the faculty at American University's Kogod School of Business. I also serve as the Managing Director of the Kogod Tax Policy Center (KTPC), which conducts non-partisan policy research on tax and compliance issues specific to small businesses and entrepreneurs. Our mission is to develop and analyze solutions to tax-related problems faced by small businesses, and promote public dialogue concerning tax issues critical to small businesses and entrepreneurs. Thank you for inviting me, and by extension, the American University students who are here with us today, to talk about the budget impact of the *Tax Cuts and Jobs Act of 2017* (P.L. 115-97) (hereinafter, "tax reform" or "TCJA") on America's families and small businesses.

Prior to joining AU's faculty, I served on the staff of the U.S. Senate Committee on Small Business and Entrepreneurship from 2009-2014, ultimately as Chief Counsel. During my tenure with the Senate Small Business Committee, I handled tax, labor and budget issues for the committee and its chair, and worked with small business stakeholders across the country and political spectrum to develop small business legislation. Before public service, I worked in private practice as a tax attorney with both PaulHastings and PwC's Washington National Tax Services.

Both my public and private sector experience have informed my research at Kogod, and today I want to share with you how my research indicates: (1) the need for a comprehensive strategy for study some of the tax expenditures included in tax reform with respect to women business owners, 99% of whom are small businesses;[1](2) how health care costs for small businesses have been impacted by tax reform; and (3) the budget implications of tax reform's failure to address the tax compliance challenges of the small business owners powering the gig economy.

[1] Michael J. McManus, *Issue Brief Number 13: Women's Business Ownership: Data from the 2012 Survey of Business Owners,* Office of Advocacy, U.S. Small Business Administration (May 31, 2017), *available at* https://www.sba.gov/sites/default/files/advocacy/Womens-Business-Ownership-in-the-US.pdf.

1. Congress Needs to Conduct Oversight on the Effectiveness and Distribution of Business Tax Expenditures with Respect to Women Businesses Owners.

The Committee's effort to conduct oversight on the budget impact of tax reform is commendable, and the Committee should develop a comprehensive strategy of study and oversight of business tax expenditures to consider their impact with respect to women business owners. Although millions of women business owners should see some tax savings from the marginal rate cuts and other expenditures included in tax reform, our research suggests that additional taxpayer investments in expenditures targeted to individuals with business income (IRC §199A) and small business owners (IRC §179) effectively "doubled-down" on a billion-dollar blind spot Congress has when it comes to women business owners and the U.S. tax code. This Committee, pursuant to House Rule X, has express jurisdiction to study this billion dollar blind spot and shed light on any findings.[2]

In June 2017, we published *Billion Dollar Blind Spot – How the U.S. Tax Code's Small Business Tax Expenditures Impact Women Business Owners*, ground-breaking research on how the U.S. tax code's small business tax expenditures targeted to help small businesses grow and access capital impact women-owned firms.[3] Our findings with respect to four specific tax expenditures targeted to small businesses (i.e., IRC §§1202, 1244, 179 and 195) raised questions as to (i) whether the U.S. tax code's small business tax expenditures were operating as Congress intended; and (ii) whether the cost of these expenditures had been accounted for in terms of their uptake by women-owned firms.[4]

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[2] Rules of the U.S. House of Representatives, Rule X, cl.4(b)(6), *available at* https://rules.house.gov/sites/democrats.rules.house.gov/files/116-1/116-House-Rules-Clerk.pdf (noting the Budget Committee's authority to "request and evaluate continuing studies of tax expenditures, devise methods of coordinating tax expenditures, policies, and programs with direct budget outlays, and report the results of such studies to the House on a recurring basis."

[3] Bruckner, C.L. (2017). *Billion Dollar Blind Spot: How the U.S. Tax Code's Small Business Expenditures Impact Women Business Owners*. Kogod Tax Policy Center Report, *available at* https://www.american.edu/kogod/research/upload/blind_spot_accessible.pdf.

[4] In *Billion Dollar Blind Spot*, we detailed the legislative history and Congress' intent to provide access to capital and opportunities for growth to small businesses with respect to four specific tax expenditures (i.e., IRC §1202 – *100% Exclusion from Capital Gains Tax for Investments in Qualified Small Business Stock*; IRC §1244 - *Ordinary Loss Treatment for Investments in Small Business Stock*; IRC §179- *Expensing for Small Businesses*; and IRC §195 – *Deduction for Qualified Start-Up Costs*). Each small business tax

This research is particularly important because although women business owners account for 40% of all U.S. firms and the total number of women-owned firms has increased over the last ten years by 58%, women business owners remain small businesses primarily operating as service firms (more than 60%) and continue to have challenges growing receipts and accessing capital.[5] Notably, women of color are the "driving force behind the growth of women-owned firms."[6] Firms owned by women of color grew at a rate of 163% during the last 10 years and today, women of color own 64% of the new women-owned businesses launched each day.[7]

Despite the good news on their increasing numbers, women business owners still struggle to access capital to grow and scale their businesses.[8] For example, a 2014 Congressional report found that access to capital is a more severe challenge for women-owned firms and that women only account for 16 percent of conventional small business loans, and 17 percent of SBA loans; which means just $1 of every $23 in conventional small business loans goes to a women-owned business.[9] At the same time, "[t]axation plays a key role in the survival and growth of small businesses, primarily through its effect on equity infusion. The major source of equity capital for expansion of a business is reinvested profits. The amount of tax the business must pay determines the amount of money available for growth and expansion."[10]

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expenditure we studied met two criteria: (i) Congress intended the provision to stimulate growth or access to capital or investment in smaller firms; and (ii) Each expenditures generated a cost to U.S. taxpayers of at least $100 million. *Id.* at 7 (noting revenue loss is a key factor in Congress relies on in determining the effectiveness of a tax expenditure).

[5] The 2018 State of Women-Owned Businesses Report, Ventureer (2018), ***available at*** https://about.americanexpress.com/files/doc_library/file/2018-state-of-women-owned-businesses-report.pdf.

[6] *Id.*

[7] *Id.*

[8] *See,* Farrell, Diana, Christopher Wheat, and Chi Mac, "Gender, Age and Small Business Financial Outcomes." (2019) JP Morgan Chase Institute (finding that "young and female small business owners are well-represented among firms that grow organically, but underrepresented among firms with external financing").

[9] Majority Report of the U.S. Senate Committee on Small Business and Entrepreneurship, 21ST CENTURY BARRIERS TO WOMEN'S ENTREPRENEURSHIP(2014),https://www.sbc.senate.gov/public/_cache/files/3/f/3f954386-f16b-48d2-86ad-698a75e33cc4/F74C2CA266014842F8A3D86C3AB619BA.21st-century-barriers-to-women-s-entrepreneurship-revised-ed.-v.1.pdf.

[10] INTERAGENCY TASK FORCE ON WOMEN BUSINESS OWNERS, THE BOTTOM LINE: UNEQUAL ENTERPRISE IN AMERICA. (U.S. Department of Commerce) (1978).

However, to date, there has been no formal government or Congressional oversight strategy on how the U.S. tax code's more than $333.5 billion of tax expenditures targeted to help small businesses grow and access capital impact women-owned firms.[11] Ultimately, taxpayers do not know if the money Congress has spent on tax breaks to help businesses access capital has been well spent or equitably distributed. This is particularly troubling considering that three of the four small business tax expenditures we studied in *Billion Dollar Blind Spot* (i.e., IRC §1202, §1244, and §179) were so limited in design that they either (i) explicitly excluded service firms (e.g., IRC §1202), and by extension, the majority of women-owned firms; or (ii) effectively bypassed women-owned firms who are not incorporated (IRC §1244) or who are service firms with few capital-intensive equipment investments altogether (IRC §179).[12]

However, neither Congress nor Treasury or SBA has ever studied or conducted oversight on how the U.S. tax code's business expenditures impact women business owners. Moreover, neither the IRS nor JCT collect data or conduct analysis on the distribution of business tax expenditures with respect to women-owned firms.[13] This means we have a billion dollar blind spot when it comes to

[11] Joint Committee on Taxation (JCT), Estimates of Federal Tax Expenditures for Fiscal Years 2018-2022, JCX-81-18 (Oct. 4, 2018), *available at* https://www.jct.gov/publications.html?func=startdown&id=5095. Total includes JCT's 5-year estimates of (1) expensing under Section 179 ($67.8B); (2) 20% deduction for qualified business income ($259B); and (3) exclusion of gain from certain small business stock ($6.7B).

[12] *Billion Dollar Blind Spot*, *supra* n. 3. As part of our research, we conducted a survey of the members of Women Impacting Public Policy (WIPP) and its coalition partners. We designed our survey to gauge whether and how familiar self-identified women business owners are with the tax expenditures we studied and whether those women-owned firms accessed them. WIPP and its coalition partners invited their memberships to participate in the online Survey Monkey survey, which was conducted from March 9, 2017 through April 11, 2017. We received 515 completed responses from women who, on their own, or with other women, owned at least 51% of a business, from the more than 550,000 WIPP or coalition partner members invited to participate in the survey. Our survey data of 515 experienced, engaged women business owners corroborated our research findings, and suggested that when women-owned firms can take advantage of tax breaks, they do (*see., e.g.,* uptake rates for IRC §195).

[13] For example, Congress designed IRC §1202, which allows angel investors to invest in qualified small business corporations, to explicitly exclude service firms. Our research found that this limitation has resulted in only a very small minority of women business owners being able to utilize it. In fact, we identified only three women business owners who had ever used IRC §1202 to raise capital for their business. Keep in mind, this is a $6.7 billion tax break Congress specifically designed to enable small businesses to attract capital. While we expect that more than three women-owned firms have used this provision since 1993, we don't have publicly-available IRS or Treasury taxpayer data to prove it. Similarly, with respect to IRC §179, our survey results found that women business owners claimed this tax break at significantly lower rates (47%) than existing government research finds for businesses generally (60% to 80%). This tax break is one of the more expensive small business tax incentives (i.e., it will cost taxpayers $67.8 billion from 2018-2022), and yet we don't have any IRS or Congressional research on how it benefits women business owners, and what research we do have suggests that women business owners benefit less than businesses generally.

understanding how effective and equitable tax expenditures are, and the latest distributional analysis from JCT on certain provisions from tax reform indicates that Congress doubled-down on it.[14]

In fact, our assessment of two of the key tax investments of the TCJA (§199 and §179), which Congress designed based on two of the small business tax incentives we studied (§1202 and §179), confirms that questions we raised in *Billion Dollar Blind Spot* were not robustly investigated in connection with Congress' efforts on tax reform.[15] Instead, Congress made additional billion dollar investments in tax expenditures that our research suggests are less favorable to women business owners in terms of distribution of tax benefits, which the JCT's April 2018 distributional analysis supports.

For example, according to Table 3 of JCT's distributional analysis of the TCJA, more than 90% of the revenue loss generated from the new deduction under IRC §199A will flow to firms with income of *more than* $100,000 in 2018 and 2024.[16] However, the most recent data available finds that 88% (or 10,775,600) of women business owners generate revenues *less than* $100,000.[17]

This inequitable distribution is even more pronounced when considered at higher income levels: only 1.7% of women-business owners have receipts of $1,000,000 or more, but JCT found in 2018, 44% of the IRC §199A will flow to pass-through businesses with $1,000,000 of income. Moreover,

[14] For more on the history of tax expenditure analysis, *see* Anthony C. Infanti, *A Tax Crit Indentity Crisis? Or Tax Expenditure Analysis, Deconstruction, and the Rethinking of a Collective Identity*, 26 Whittier L. Rev. 707 (2005).

[15] We submitted summaries of our research and links to Billion Dollar Blind Spot to multiple Congressional committees in 2017 during the tax reform debate. *See e.g.*, Bruckner, Caroline (July 27, 2017). *Statement for the Record to the U.S. House of Representatives Committee on Ways & Means Tax Policy Subcommittee in connection with July 13 hearing, "How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs."*; Bruckner, Caroline (July 17, 2017). *Submission to the U.S. Senate Finance Committee in Response to the Chair's Request for Recommendations for Tax Reform*; Bruckner, Caroline (June 28, 2017). *Statement for the Record to the U.S. Senate Committee on Small Business and Entrepreneurship in Connection with the June 14 Hearing Titled, "Tax Reform and Barriers to Small Business Growth." See also,* Bruckner, C. L. (August 30, 2017), *"Women in Business Must Be a Priority in U.S. Tax Reform Plans"* FINANCIAL TIMES, *available at https://www.ft.com/content/ebda758c-8cb7-11e7-a352-e46f43c5825d*.

[16] JCT, *Tables Related to the Federal System as in Effect 2017 through 2026 (JCX-32R-18)*, (April 24, 2018), *available at* https://www.jct.gov/publications.html?func=startdown&id=5093.

[17] The 2018 State of Women-Owned Businesses Report, *supra* n. 5 at 9.

JCT projects that the 44% will increase to 52% by 2024.[18] These alarming estimates warrant immediate study and oversight by this Committee. Taxpayers are entitled to: (i) a government accounting of the distribution of the $415 billion JCT estimated Section 199A will cost with respect to women business owners; and (ii) an analysis as to whether high-earning women businesses owners—the majority of whom are in services and are excluded from claiming Section 199A above certain thresholds—will be effectively barred from being able to use this tax break to grow their businesses.[19]

While most women business owners will no doubt see some limited benefit from IRC §199A, JCT's distributional analysis raises serious questions as to the equity of the distribution of this tax expenditure with respect to women-owned firms, who constitute 40% of all U.S. firms. In addition, our research suggests additional oversight and tax research is warranted with respect to the TCJA's investments into expanding IRC §179.

2. Impact of Tax Reform on Health Care Costs for Small Businesses

One of the most concerning aspects of tax reform is impact on health care costs for small businesses. Small businesses remain deeply concerned regarding the affordability of health care.[20] In fact, the 4.4 million self-employed small business owners who purchase health care for themselves and their families on the individual market are acutely vulnerable to increases in

[18] JCT, *supra* n. 16 at Table 3. *See also*, Exhibit A.

[19] In general, the deduction is available to sole proprietors, independent contractors, and owners of S corps, partnerships, and LLCs. However, if taxable income exceeds certain thresholds ($315,000 MFJ, $157,500 everyone else), and business is a "specified service trade or business," no deduction is available. For purposes of Section 199A the term "Specified Service Business" is based on Section 1202 and includes firms involving performance of services in fields of *health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services*, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners or involves performance of services involving investing or trading. As noted in Exhibit A, half of women-owned businesses are concentrated in three industries: other services, health care and social assistance, and professional/scientific/technical services.

[20] *See, e.g.*, NFIB Letter to Ways and Means Chair Brady (Jan. 2018), *available at* https://www.nfib.com/assets/NFIB-Letter-of-Support-Healthcare-Tax-Delay-Legislation-01-2018.pdf.

healthcare costs, which represent a "material expense for nonemployer business owners."[21] As part of tax reform, Congress effectively eliminated the penalty that individual taxpayers who have no health insurance and are not exempt from the mandate must pay. In November 2017, during the tax reform debate, CBO issued a report finding that repealing the individual mandate would result in 4 million fewer people carrying insurance in 2019 and 13 million in 2027.[22] In addition, CBO found that "average premiums in the nongroup market would increase by about 10 percent in most years of the decade."[23] Essentially, CBO found that eliminating the individual mandate would mean fewer healthy people would buy insurance, "especially in the nongroup market" and "the resulting increases in premiums would cause more people not to purchase insurance."[24] More than a year later, there is some evidence CBO's estimates were accurate.

For example, an October 2018 issue brief prepared by the Kaiser Family Foundation found that "among insurers that publicly specify the effect of these legislative and policy changes in their filings to state insurance commissioners, we found that 2019 premiums will be an average of 6% higher, as a direct result of the individual mandate repeal and expansion of more loosely regulated plans than would otherwise be the case."[25] Although health care insurance premiums "may be flat or even falling in some places, they would be substantially lower still if not for these policy changes."[26]

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[21] Farrell, Diana, Christopher Wheat, and Chi Mac (2017), "Paying a Premium: Dynamics of the Small Business Owner Health Insurance Market." JPMorgan Chase Institute, *available at* https://www.jpmorganchase.com/content/dam/jpmorganchase/en/legacy/corporate/institute/document/institute-smb-health-insurance.pdf.

[22] Congressional Budget Office, *Repealing the Individual Health Insurance Mandate: An Updated Estimate* (Nov. 2017), available at www.cbo.gov/publications/53300. CBO also found that repealing the individual mandate would reduce deficits by $338 billion between 2018 and 2027.

[23] *Id.*

[24] *Id.*

[25] Kaiser Family Foundation, *How Repeal of the Individual Mandate and Expansion of Loosely Regulated Plans are Affecting 2019 Premiums* (Oct. 2018), *available at* https://www.kff.org/health-costs/issue-brief/how-repeal-of-the-individual-mandate-and-expansion-of-loosely-regulated-plans-are-affecting-2019-premiums/.

[26] *Id.*

And it's not just an increase in premiums that are a cause for alarm with respect to the impact of tax reform. The reported lower refunds taxpayers are receiving as a result of changes in withholding may have unintended, but nevertheless, painful consequences for taxpayers who anticipated higher refunds. For example, banking industry research shows that Americans "increase their out-of-pocket healthcare spending by 60 percent in the week after receiving a tax refund, and the majority of the increase goes towards in-the-moment, in-person care."[27] For those taxpayers who this year are receiving lower refunds, they may have to wait even longer to pay for needed healthcare costs. Although tax reform did in fact create tax savings for most Americans, the distribution of those savings through lower withholding rather than through a higher refund amount may have unintended health care purchasing implications. This Committee should be aware of and tracking these issues in connection with its oversight efforts of tax reform's impact on American families.

3. Tax Reform's Failure to Help Small Businesses Driving the Gig Economy

Finally, I am very concerned that tax reform failed to address the tax compliance challenges of the 2.3 million Americans working side-hustles every month in the gig economy, which directly impact these taxpayers' ability to pay their taxes and be credited with Social Security contributions.[28] In 2016, I published research detailing the findings of a survey on the tax compliance challenges of gig economy workers, and found that more than 60% of the population I surveyed did not receive any tax forms for the income they earned working with a platform and the IRS didn't either. This is because gig economy platforms such as Uber, Lyft, Esty, Airbnb and others are not required to report to the IRS income paid electronically or to send information reporting forms to service

[27] Farrell, Diana and Fiona Greig. "On the Rise: Out-of-Pocket Healthcare Spending in 2017." JPMorgan Chase Institute, (2018), *available at* https://www.jpmorganchase.com/corporate/institute/document/institute-on-the-rise-report.pdf; Farrell, Diana, Fiona Greig and Amar Hamoudi "Filing Taxes Early, Getting Healthcare Late: Insights from 1.2 million households" JPMorgan Chase Institute (2018), *available at* https://www.jpmorganchase.com/corporate/institute/insight-filing-taxes-early.htm.

[28] Bruckner, C.L. and Thomas Hungerford (2019). *Failure to Contribute: An Estimate of the Consequences of Non-and Underpayment of Self-Employment Taxes by Independent Contractors and On-Demand Workers*. Boston College Center for Retirement Research Working Paper, *available at* https://crr.bc.edu/working-papers/failure-to-contribute-an-estimate-of-the-consequences-of-non-and-underpayment-of-self-employment-taxes-by-independent-contractors-and-on-demand-workers-on-social-security/.

providers and sellers until a $20,000 and 200 transaction threshold is met.[29] However, the majority of gig economy workers do not earn enough income or engage in enough transactions over the course of a year to trigger information reporting.[30] This means that there is a 63% likelihood that the billions of dollars these millions of taxpayers earn is misreported.[31] I testified before the House Small Business Committee as to these findings in 2016 and 2017, and worked extensively with Congressional staff in the last Congress to develop bipartisan legislation, the *Small Business Owners Tax Simplification Act* (H.R. 3717), to help these taxpayers.[32]

Notwithstanding these efforts, the final tax reform legislation failed to address this issue, which is a growing problem that subjects millions of taxpayers to audit and penalty exposure. In fact, recent IRS data shows that the underpayment of estimated taxes rose 40% from 2010 to 2015 up to 10 million from 7.2 million.[33] As a result, there are significant budget and Social Security consequences for taxpayers for this growing problem. For example, in January, Boston College Center for Retirement Research published my latest research, Failure to Contribute, which reviewed existing estimates on the size and growth of the gig economy and independent contractors, and estimated that in 2014 alone, the independent contractors and gig workers I studied failed to properly report more than $7.35 billion in self-employment taxes. Moreover, the

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[29] Bruckner, C. L. (2016). *Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy*. Kogod Tax Policy Center Report, *available at* https://www.american.edu/kogod/news/Shortchanged.cfm.

[30] Diana Farrell, Fiona Greig, & Amar Hamoudi. 2018. "The Online Platform Economy in 2018: Drivers, Workers, Sellers and Lessors." JPMorgan Chase Institute (Sept. 2018), https://www.jpmorganchase.com/corporate/institute/document/institute-ope-2018.pdf (finding average month income ranges in four key sectors of the gig economy were: (1) transportation ($783/month); (2) leasing ($1,736/month); (3) selling ($608/month); and other services ($793/month) and that earnings represented a major sources of supplemental not primary income).

[31] *Shortchanged, supra* n. 28 (citing U.S. tax gap data noting that where income is not subject to withholding or information reporting there is a 63% chance of taxpayers misreporting).

[32] Bruckner, C. L. (February 15, 2018). *"Congress Failed to Fix Tax Woes for Gig Workers."* The Chicago Tribune, *available at* https://www.chicagotribune.com/news/opinion/commentary/ct-perspec-gig-economy-taxes-uber-lyft-airbnb-0216-20180215-story.html. *The Sharing Economy: A Taxing Experience for New Entrepreneurs Part I: Hearing Before the U.S. House Comm. on Small Business*, 114th Congress (testimony of Caroline Bruckner) (May 2016), https://smallbusiness.house.gov/uploadedfiles/5-24-16_bruckner_testimony_.pdf ("House May 2016 Testimony"); *Small Business Tax Reform: Modernizing the Code for the Nation's Job Creators: Hearing Before the U.S. House Comm. on Small Business*, 115th Congress (testimony of Caroline Bruckner) (Oct. 2017), https://smallbusiness.house.gov/uploadedfiles/10-4-17_bruckner_testimony.pdf.

[33] Laura Saunders, *Number of Americans Caught Underpaying Their Taxes Surges 40%*, THE WALL STREET JOURNAL, (Aug. 11, 2017) *available at* https://www.wsj.com/articles/the-numberof-americans-caught-underpayingsometaxes-surges-40-1502443801.

problem of underreporting is not confined to platforms who don't furnish 1099-Ks to their service providers and sellers. Following our research, Treasury's Inspector General released a new report earlier this month finding that the expansion of the gig economy warrants a focus on improving self-employment tax compliance because, in part, IRS failed to work cases for TY 2012 to TY2015 involving $12 billion of payments by gig platforms to workers that potentially wasn't reported.[34] Last month, the Chair and Ranking Member of the House Small Business Committee once again introduced bipartisan legislation to address this issue (H.R. 593, *Small Business Owners' Tax Simplification Act*), and going forward, I urge members of this Committee to consider the growing budget implications of failure to act to facilitate tax compliance by these workers and platforms.

Conclusion

This Committee should be congratulated on holding this hearing and immediately set to work to develop the needed oversight on the distribution of business tax expenditures with respect to women business owners. The existing lack of research and effective Congressional oversight on how business tax expenditures impact women business owners constrains policymakers from developing evidenced-based policymaking on the effectiveness of tax expenditures overall and denies taxpayers information crucial to understanding how their money is being distributed among firms. In addition, this Committee should continue to track the budget implications of how tax reform's changes impact the affordability of health care for small businesses. Finally, this Committee should study the ongoing and growing budget implications of the expanding gig economy. We stand ready to aid the Committee in this important work on behalf of the millions of small businesses impacted by these issues.

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[34] U.S. Treasury Inspector General for Tax Administration, *Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance*, Reference Number: 2019-30-016 (Feb. 14, 2019), *available at* https://www.treasury.gov/tigta/auditreports/2019reports/201930016fr.pdf.

Chairman YARMUTH. Thank you very much.

I now recognize Ms. Pol for five minutes.

STATEMENT OF LANA POL

Ms. POL. Good morning, Chairman Yarmuth, Ranking Member Womack and members of the House Budget Committee. My name is Lana Pol. I am an owner of multiple small businesses in and around Pella and Des Moines, Iowa. I serve as the president of Geetings, Incorporated; G.I. Warehouse Corporation; Mowbility Sales and Service; and Creative Inspirations. Thank you for inviting me today to testify.

Geetings, Incorporated, was founded in 1972 by my father, Delroy Wayne Geetings. Dad completed only a sixth-grade education but his drive and motivation made him a successful entrepreneur. His many businesses included a landfill, a filling station, a pool hall, a car dealership and an excavating company. Forty-seven years later, the company continues to operate using Dad's motto for life, "If it's worth doing, it's worth doing right."

In 1975, Geetings expanded to the nearby town of Knoxville with the building of a warehouse and the founding of G.I. Warehouse Corporation. Additional warehouses were built to fulfill demand. Geetings, Incorporated, and G.I. Warehouse Corporation continue to operate based on Dad's original values of integrity, honesty, respect and loyalty and are committed to delivering quality service one customer at a time.

I joined the company on a full-time basis in 1975. I bought out my retiring brothers in 2011 and 2012 and became the sole owner of Geetings, Incorporated, and G.I. Warehouse Corporation. In 2015, I carried on my father Wayne's tradition of entrepreneurship and opened two new small businesses along with the next generation, my children. Mowbility Sales and Service is an outdoor power equipment retailer and service provider in Pella and Des Moines. Mowbility recently purchased Odyssey Spas and moved into selling new products like spas, swimming pools and hot tubs. Creative Inspirations is a promotional product distributor, specializing in apparel and customer fulfillment also in Pella. Both of these businesses are rapidly expanding. I hope to pass the businesses on to the third and fourth generations of our family.

The 2017 Tax Cuts and Jobs Act provided tax relief that allowed us to invest in our employees with raises and invest in our businesses with a significant facility expansion and new vehicles. The new tax law also increased local and national business confidence. Together, these factors continue to benefit our local and national economies. Two of the most significant direct benefits from the new tax law for our businesses were the creation of the new small business deduction, Section 199A, and the expansion of the small business expension, Section 179.

For tax filing purposes, our businesses are organized as S corporations and LLCs, meaning the business earnings flow through to my individual tax return. The vast majority of small businesses are organized similarly. The creation of the new small business deduction provides substantial tax relief for businesses like ours, with a deduction up to 20 percent from business income.

My accountant informed me that the new small business deduction will provide around $40,000 in tax relief for our businesses. This tax relief provides crucial cash flow that allowed us to provide up to $4,000 raises to our employees, the largest raises we have been able to provide in recent years. These raises increased employees' take-home pay and helped us retain employees. As you know, businesses across the country are experiencing tight labor markets, an indicator of a strong economy. The labor market is especially tight in Iowa. Retaining high-valued employees is key for our business to function.

Additionally, we invested $2 million in a nearly 40,000-square-foot expansion of G.I. Warehouse Corporation, which was completed in December. We are now up to 460,000 square feet in warehouse space. We have filled the warehouse space, another strong economic sign.

The new tax law doubled the small business expensing thresholds of the tax code from 500,000 in 2017 to over a million dollars in 2018. This expansion incentivized us to purchase six new semi-trucks totaling a million dollars and will allow us to immediately expense the cost of the trucks in 2018 instead of depreciating that amount over several years.

I have observed other small businesses in and around Pella also investing in employees and companies. Multiplying our experience by millions of small businesses around the country demonstrates significant economic benefits resulting from the Tax Cuts and Jobs Act.

Many of the provisions benefitting individuals and small businesses, like the small business deduction, sunset after 2025. That sunset date makes small business owners nervous about future expansion. To provide long-term certainty and confidence for small businesses, Congress should make these provisions permanent. I urge Congress to pass bills like the Main Street Tax Certainty Act.

Thank you for the opportunity to testify. I look forward to answering any questions.

[The prepared statement of Lana Pol follows:]

TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS



Written Testimony of Lana K. Pol

President/Owner, Geetings, Inc.

before the

United States House of Representatives
Committee on the Budget

2017 Tax Law: Impact on the Budget and American Families

Wednesday, February 27, 2019

NFIB
1201 F Street, NW Suite 200
Washington, DC 20004

Good morning, Chairman Yarmuth, Ranking Member Womack, and members of the House Budget Committee. My name is Lana Pol. I am an owner of multiple small businesses in and around Pella and Des Moines, Iowa. I serve as the President of Geetings, Inc., G.I. Warehouse Corporation, Mowbility Sales and Service, and Creative Inspirations. Thank you for inviting me to testify at this important hearing on the 2017 tax law's impact on the budget and American families.

Geetings, Inc. was founded in 1972 by my father, Delroy "Wayne" Geetings. Dad completed only a sixth-grade education, but his drive and motivation made him a successful entrepreneur. His many businesses included a landfill, a filling station, a pool hall, a car dealership, and an excavating company. Forty-seven years later, the company continues to operate using Dad's motto for life: "If it's worth doing, it's worth doing right!"

In 1975, Geetings expanded to the nearby town of Knoxville with the building of a warehouse and the founding of G.I. Warehouse Corporation. As the need for storage space increased, additional warehouses were built to fulfill demand. Geetings, Inc. and G.I. Warehouse Corporation continue to operate based on Dad's original values of integrity, honesty, respect, and loyalty, and are committed to "delivering quality service, one customer at a time!" We also value community, responsibility, equality, innovation, family, attitude, uniqueness, and faith.

I joined the company on a fulltime basis in 1975. I bought out my retiring brothers in 2011 and 2012 and became the sole owner of Geetings, Inc. and G.I. Warehouse Corporation. In 2015, I carried on my father Wayne's tradition of entrepreneurship and opened two new small businesses along with the next generation, my children. Mowbility Sales and Service is an outdoor power equipment retailer and service provider in Pella and Des Moines. Mowbility recently purchased Odyssey Spas and moved into selling new products like spas, swimming pools, and hot tubs. Creative Inspirations is a promotional product distributor specializing in apparel and customer fulfillment in Pella. Both of these businesses are rapidly expanding. I hope to pass the businesses onto the third and fourth generations of our family.

The 2017 *Tax Cuts and Jobs Act* provided tax relief that allowed us to invest in our employees with raises and our businesses with a significant facility expansion and new vehicles. The new tax law also increased local and national business confidence and optimism. Together, these factors continue to benefit our local and national economies. Two of the most significant direct benefits from the new tax law for our businesses were the creation of the new Small Business Deduction (Section 199A) and the expansion of Small Business Expensing (Section 179).

For tax filing purposes, our businesses are organized as pass-through entities – S corporations and LLCs – meaning the business earnings flow through to my individual tax return. The vast majority of small businesses are organized similarly as pass-through entities. The creation of the new Small Business Deduction (Section 199A) provides substantial tax relief for businesses like ours, allowing pass-throughs to deduct up to 20 percent from business income.

My accountant informed me that the new Small Business Deduction (Section 199A) will provide

around $40,000 in tax relief for our businesses. This tax relief from the new tax law provides crucial cash flow that allowed us to provide up to $4,000 raises to our employees, the largest compensation increases we have been able to provide in recent years. These raises increased employees' take-home pay and helped us retain employees. As you know, businesses across the country are experiencing tight labor markets, an indicator of a strong economy. The labor market is especially tight in Iowa. Retaining highly-valued employees is key for our businesses to function.

We are not alone. Record levels of small business owners are increasing employee compensation. Over the last 14 months since the enactment of the new tax law, at least 30 percent of small business owners have reported compensation gains each month, a level that had been reached only once since 2001.[1]

Additionally, we invested $2 million in a nearly 40,000 square foot expansion of G.I. Warehouse Corporation, which was completed in December. We are now up to 460,000 square feet in warehouse space. We have filled the warehouse space, another strong economic sign.

The new tax law doubled the Small Business Expensing (Section 179) thresholds of the tax code from $500,000 in 2017 to over $1 million in 2018. This expansion incentivized us to purchase six new semi-trucks totaling $1 million and will allow us to immediately expense the cost of the trucks in 2018 instead of depreciating that amount over several years.

I have observed other small businesses in and around Pella also investing in employees and companies. Nationally, the NFIB Small Business Optimism Index has remained historically high throughout 2018 and early 2019. We have experienced this optimism firsthand. Multiplying our experience by millions of small businesses around the country demonstrates significant economic benefits resulting from the *Tax Cuts and Jobs Act*.

Congress can help further. Many of the provisions benefitting individuals and small businesses – like the Small Business Deduction (Section 199A) – sunset after 2025. That sunset date makes small business owners nervous about expansion. To provide long-term certainty and confidence for small businesses, Congress should make these provisions permanent. The House of Representatives voted to make these provisions permanent last September. I urge similar votes this Congress on bills like H.R. 216, the *Main Street Tax Certainty Act*.

Thank you for the opportunity to testify. I look forward to answering any questions.

[1] NFIB Research Center, *NFIB Small Business Economic Trends*, February 12, 2019.

Chairman YARMUTH. I thank you all for your testimony. We will now begin the question and answer part of the hearing. And, as is our habit, the ranking member and I will defer our questions to the end. So I now recognize Mr. Higgins of New York for five minutes.

Mr. HIGGINS. Thank you, Mr. Chairman.

Firstly, Dr. Gale, you had talked about three criteria as it relates to testing growth, fairness and a fiscal test, all of which this tax cut failed. Is there any tax cut that actually pays for itself?

Mr. GALE. There certainly are situations where reducing a tax rate could pay for itself. For example, if you had a 95 percent tax rate on some form of income, you reduced it to 90 percent, you would likely end up raising revenues because you are doubling the after-tax return there from 5 to 10 cents on the dollar. But none of that really applies. We are way over on the other side of the so-called Laffer curve.

Mr. HIGGINS. Mark Zandi from Moody's Analytics, a former adviser to John McCain, had said that the best-case scenario for a corporate tax cut is a return of 32 cents for every dollar that you give away in a tax cut, corporate tax cut. So that would say to me that your return on investment from that tax cut is minus 68 percent. Is that a fair characterization?

Mr. GALE. We will clearly get some revenue offset from corporate tax cuts. There will be some, we will not lose 100 percent. But it really depends on what part of the corporate tax system is cut. Cutting the rate, which is what happened in 2017, is the least efficient way to generate new investment. Because a huge amount of current corporate investment is income from investment in the past. And so cutting the rate does not do anything to boost investment in the past. You get a much bigger bang for the buck if you give incentives to new investment.

So, for example, if we raise the corporate rate to 25 or 28 but also moved all the way to expensing, we would get more investment and more revenues than the current system.

Mr. HIGGINS. When this corporate tax bill was originally made public as a proposal, the White House Council of Economic Advisers had stated in a formal communication to the House Ways and Means Committee that this proposed tax cut would increase household income by between $4,000 and $9,000 and this would be recurring, this would happen on an annualized basis. I do not have any evidence that that materialized. Is there any evidence that there has been an increase in household income to the extent to which the White House Council of Economic Advisers had stated that it would?

Mr. GALE. Well, the CEA was very careful not to specify a date by which that would happen. So I do not think anyone expected it to happen in the first year. But they expect income to rise by 4,000 to 9,000 above what it otherwise would have risen. I find that extremely unlikely and I will refer back to the CBO numbers I mentioned earlier that, after 10 years, national income will only go up by one tenth of 1 percent.

Mr. HIGGINS. Who is the Council of Economic Advisers?

Mr. GALE. The White House group of economists.

Mr. HIGGINS. And that would include perhaps the Treasury Secretary?

Mr. GALE. No, sir. The CEA is set of staff members. There are three members of the council, Kevin Hassett being the head of the council right now. And I think there are about 15 or 20 staff members, that they work for the White House.

Mr. HIGGINS. Okay. How could they be so far off?

Mr. GALE. The document cites the literature in a number of ways. But I and others, when we look at the literature, reach different conclusions than the CEA does.

Mr. HIGGINS. Who is the author of the literature?

Mr. GALE. There are numerous, numerous articles.

Mr. HIGGINS. So they are economists. They are looking for literature presumably from other economists. So I am just kind of curious as to what the Council of Economic Advisers, who would they defer to in order to inform them of a decision that they have to make a formal report on the White House Council of Economic Advisers stationery to Congress.

Mr. GALE. Normally, they would look at the academic literature. But it is not always easy to interpret these numbers. For example, there was a study in Germany that half of the corporate tax is passed on to workers and people try to use that in the United States but it is not a valid comparison because the governmental units in Germany are much smaller than the overall size of the U.S. economy, so the amount of shifting of the tax will be different.

Mr. HIGGINS. I know my time has expired but let me just say this. So the White House Council of Economic Advisers, who make a report to Congress, may have made reference to the literature on economics that was established by economists in Germany?

Mr. GALE. So they cite a lot of the literature. My point is, I think that I and others who have looked at the same literature would reach different conclusions from it.

Mr. HIGGINS. I yield back, thank you.

Chairman YARMUTH. The gentleman's time has expired. I now recognize Mr. Flores from Texas for five minutes.

Mr. FLORES. Thank you, Mr. Chairman. I appreciate the panel for joining us today.

Some of the testimony today, I think, has been somewhat inflammatory and a little bit reckless, particularly economically reckless. I note that on the panel, there is really only one person there who, like me, has signed the front side of a paycheck. And I would submit that gives us a much better understanding of the real-world economy versus the understanding that may come from looking at a model.

I have a couple examples of the tax impact. I just exchanged text messages with a person who owns Blackhawk Aero in Waco, Texas. He describes this as a mom-and-pop business that is celebrating its twentieth anniversary this year that has gone from zero to $90 million in revenues during that 20-year process.

Here is what he says. He says the tax cuts can be directly attributable to our significant increase in business. Buyers are able to take advantage of the 100 percent depreciation on our products that we sell, so the sales uptick increased dramatically by about 40 percent. And then I am going to go on. He said, we have been able to raise pay, we have been able to invest in new facilities, we have been able to grow our employee base. And all of that made 2018

a record year, and they believe 2019 will be equally as good, moving forward.

So then I go to another part of my district down in Bryan-College Station, Texas. And there is a business there called Village Foods and Pharmacies. And it says, to highlight the direct results of the Tax Cuts and Jobs Act, the owner has said that they have been able to put together bonuses and a brand new 401(k) program for all employees.

And this is just like these stories you hear all over the country. This is the real world. This is not something where we are trying to reflect some sort of the inflammatory rhetoric that we heard before.

One of the things that I think is interesting is the talk about a carbon tax. A carbon tax would hit the families that some of these witnesses talked about as having been impacted adversely by the Jobs Act, even though they have more pay than they had before and more job opportunities than they had before. It has been said a carbon tax would hurt them the worst. Their cost of living would go up dramatically under a carbon tax regime. And with the somewhat promise that they would get some of it back from Washington. We have seen Washington break too many promises.

We have heard claims that the tax act has increased the deficit. But, you know, as a person in the real world, when my revenues go up, then I am better off. And the country's revenues, the federal government's revenues have gone up from 2017 to a record in 2018, and they are on track to go up again for another record in terms of receipts by the federal government in 2019. It is hard for me to see how that increases the deficit.

Now, what does increase the deficit is spending. And this goes back to what the GOP leader said a minute ago, in that we do not have a revenue problem, we have a spending problem. And so we need to look at ways to address the spending.

What we have heard from the other side of the aisle are huge programs they want to roll out like the Green New Deal, which, just we got a cost estimate on it the other day of $93 trillion, which would represent about 90 percent of the wealth of all the families in this country.

Ms. Pol, I have a question for you, since again you operate in the real world, not in an academic world, and you have an understanding of what it means, the challenges it means when you hire somebody and you sign the front side of their paycheck every few days.

Can you talk about the impact of some of the tax proposals you heard from the other witnesses in their testimony?

Ms. POL. One of the things that was talked about that really stuck out to me was the health care, that it just, that that cost health care to go up. My experience has been in the last five years, we have had health care increases of 17 percent, 19 percent, 29 percent and again this year now to 9 percent. So I don't think that the tax, this law, had anything to do with this. This is prior to that. And that was through Obamacare when everything started skyrocketing on us. So that was one of the reasons that we were having a hard time. We have, since 1975, paid 100 percent of our employees' health care costs, family and all. They have no cost out

of pocket. And it did not allow us to give any raises. And so that is why this was significant for us to have the raises this year.

Mr. FLORES. Thank you. I yield back the balance of my time.

Chairman YARMUTH. I thank the gentleman. I now recognize Mr. Scott of Virginia for five minutes. Oh, Mr. Doggett is back. Mr. Doggett of Texas for five minutes. Sorry.

Mr. DOGGETT. Thank you very much, Mr. Chairman. In many ways, the best label for this tax law is the whopper. And there has just been one whopper after another about it. I think Mr. Higgins just referred to one of the most significant ones, the claim that Americans would receive on average $4,000 in additional household income every year. We now know that not only do Americans have good reason to be asking, where is my $4,000, or as Secretary Mnuchin put it, it would be $4,500 that we would be getting because, in fact, the estimates I have seen is that over 95 percent of American workers have not received any bonuses or any wage hikes due to this Republican tax law.

So while there may have been a sugar high for the economy in the short term, we know immense debt is coming our way. And the $4,000 is just still not available for most Americans.

But that is not the only whopper. And, Ms. Huang, I would I would like to discuss with you the portion of your testimony that focused on the international side. Because certainly among those who received the greatest rewards were multinational corporations. In fact, they got a bonanza out of this.

Now, President Trump, on one of his many tours to the golf course, apparently told executives that we could expect $4 trillion that would just come pouring back when they gave this discounted rate on these so-called repatriated earnings abroad. How near have they come to the $4 trillion of repatriated earnings coming back to invest and create jobs here in America?

Ms. HUANG. So I think nobody has been able to figure out where that 4 trillion came from and, to date——

Mr. DOGGETT. Well, that is like a lot his numbers.

Ms. HUANG. And to date, we have seen about 500 billion in repatriated earnings. And we have also seen very little of that flow through into increased investment or wages.

Mr. DOGGETT. Right. Because, as we expressed concern when that tax law was being written, in fact what happened the last time they had a repatriation, the same thing happened again. And that is, the money flowed into stock buybacks and to dividends. So, if you were one of the American families who had stocks in one of these companies, you maybe did well. But very few, a very small portion had that.

Is it correct that almost all of the money that has come back has gone into stock buybacks and dividends and some increase in executive pay?

Ms. HUANG. And that is absolutely not surprising, as you said. I think we mentioned earlier CEA Chair Kevin Hassett. Before this bill was enacted, another one of his promises was the suggestion that a lot of that money would flow through directly into investments in factories and jobs in the U.S., combined with the cut in the corporate rate.

If you notice his language since the bill was enacted, he has kind of changed his story since then and saying now, oh, well, it was kind of expected that you would get this one-time sort of glut of buybacks and dividends and so on and so forth. So, the ultimate increase in wages for workers seems to be getting further and further away in terms of what we are being promised.

Mr. DOGGETT. And then another one of the whoppers that was told was that there were things in this tax bill that were going to prevent the outsourcing of American jobs. In fact, are there not a number of provisions that have been added by Republicans in this tax law, such as the fact that you might pay nothing or no more than half of what you would pay here in America in taxes if you invest in Shanghai instead of investing in San Antonio?

Ms. HUANG. That's absolutely right. The basic structure of the law is that there is a permanently low discounted rate on foreign profits as opposed to profits earned in the U.S. And the law in a way recognizes that problem and it has a whole series of guardrails to try to stop shifting of profits and investment offshore. But one of these very measures creates its own new incentive to actually shift investment offshore.

Mr. DOGGETT. As I think you know, I have outsourcing legislation to try to close all those loopholes. Is it important to protect American jobs by closing these giant loopholes that Republicans created in their tax law to encourage the outsourcing of jobs and investment from our country to abroad?

Ms. HUANG. It is vitally important. And also important to protect that revenue that could be put to better use investing in infrastructure and other shared priorities that would help the economy at home.

Mr. DOGGETT. Thanks to all of you. I yield back.

Chairman YARMUTH. The gentleman's time has expired. I now recognize Mr. Johnson of Ohio for five minutes.

Mr. JOHNSON. Thank you, Mr. Chairman. I want to thank our witnesses for being with us today to have this very, very important discussion. You know, especially you, Mrs. Pol, for providing a voice of reason for small businesses. That is so vitally important here. Small businesses create roughly 60 percent of the jobs in America. And without what you and others like you do, our economy falters in a very, very big way. So thanks for being here.

You know, in my part of Ohio, small businesses like yours, one for example, Bully Tools in Steubenville, are staples of the economy and employ their neighbors in good paying jobs. Bully Tools manufactures equipment for gardening, roofing and other work and is in the planning stages of opening a second factory, due to the tax reforms that were passed last session, the Tax Cuts and Jobs Act. They were also featured at President Trump's "Made in America Showcase" in the summer of 2017 as the business representative from Ohio.

The people I represent in eastern and southeastern Ohio are, by and large, hardworking members of the middle class. But, contrary to the rhetoric on the other side, they have seen real benefits from the Tax Cuts and Jobs Act.

There have been some clear benefits for small businesses like Bully Tools, such as increasing the thresholds for the estate tax

and the alternative minimum tax. And for the 85 percent of families in my district who take the standard deduction, more of their money is tax free because the Tax Cuts and Jobs Act nearly doubles the standard deduction for married couples and individual filers. With more money at home, families can support our small businesses.

So, Mrs. Pol, have you seen this type of indirect benefit of tax reform in your community and businesses like yours?

Ms. POL. Yes, we have seen our town really growing and we have seen new businesses coming in. We have two large corporations, Pella Corp. and Vermeer's, that supply a lot of our small businesses with work. And that is one of the reasons I am able to build a warehouse. So with this coming through, even though some of it is going to the large corporations, they are turning it around and also allowing small businesses to gain from it, which allows employees to gain.

Mr. JOHNSON. Okay, well, thank you. You know, one of the most often repeated criticisms of the Tax Cuts and Jobs Act is that they are supposedly driving our country off a fiscal cliff. The reality is that, even with the tax cuts, the federal government is projected to bring in a staggering $46 trillion in revenue over 10 years. No nation in the world has ever collected more. The federal government clearly has a spending problem, not a revenue problem. And it is the out-of-control mandatory spending that is the driver of our deficits.

What I find disconcerting is twofold. My Democrat colleagues have proposed to dramatically increase mandatory spending with a new spending wish list costing over $50 trillion over the next decade. And, second, they want to pay for their new priorities by increasing taxes on Americans. I am assuming this would include rolling back the tax relief that the Tax Cuts and Jobs Act brought for all Americans.

I would refer my colleagues in the majority to an article that came out in Roll Call just today. There are some examples. Look at the big blue states, states like New York, California, Illinois that are struggling to make ends meet. They have got rising deficits. Look at states on the other hand—by the way, those states have really high tax rates. Look at states like Texas and Florida and other states who have understood that there is a phenomenon that occurs when you allow the American people to keep more of the money that they earn.

Now it does not match up with the static scoring of CBO and others here in Washington, where we play funny money deals. But I can tell you that the American people know real money when it is in their pocket.

So, Dr. Gale, do you think it would be plausible to increase taxes to fully pay for the spending wish list? And, if so, what kind of tax increases would you suggest to pay for this $50 trillion of new spending?

Mr. GALE. The CBO estimates of TCJA that show that TCJA loses substantial amounts of revenue are not static estimates, they are fully dynamic.

Mr. JOHNSON. That is not the question I asked you. I asked you what kind of tax increase do you think it would take to pay for this $50 trillion wish list?

Mr. GALE. I think there are a number of tax increases. We should pursue the carbon tax with offsets for low-income households as clearly one of them. The value-added tax with offsets for low-income households is clearly another. How we get all the way to the number you specified is a different question. But it——

Mr. JOHNSON. That is not a number I specified; that is their wish list. That is the Democrat wish list, 50 trillion, so——

Mr. GALE. How we get to the number you asked me about is a different question. I think that even if we do generate judicious spending cuts in Social Security and Medicare, if you look at the arithmetic of the budget outlook, we will need to raise tax revenues.

Mr. JOHNSON. Please note, Mr. Chairman, I must qualify, I never said cut Social Security and Medicare. I want to make sure. Those were your words. That is not where I am suggesting that we cut.

Chairman YARMUTH. Okay, the gentleman's time has expired. I now recognize Mr. Scott of Virginia for five minutes.

Mr. SCOTT. Thank you, Mr. Chairman. Mr. Chairman, the ranking member has frequently asked us what our plan is, and I just put this chart up here to show that during Republican administrations, the deficit gets worse; during Democratic administrations, the deficit gets better. We had PAYGO, where if you have a wish list you have to pay for it. And therefore, as opposed to tax cuts that are not paid for and put us in the ditch.

So in response to the question, our plan is the blue, their plan is the red. And in terms of jobs, next chart, you can see where jobs have gotten better. In about 1990, there was a bipartisan bill where President Bush, I guess we misread his lips, and jobs got better. During the Clinton administration, they got better. You can see it in 2009, at the bottom of 2009, President Obama had an economic plan.

We passed a $1.5 trillion economic plan and you cannot point to where on that chart it even made any difference. So in terms of what our plan is, if we could get back to Democratic administrations, we would have a much better budget.

Dr. Gale, let me ask you a question on tax cuts generally. Some tax cuts stimulate the economy, some do not. Which tax cuts tend to stimulate the economy?

Mr. GALE. You will get the biggest bang for the buck for tax cuts that get spent rather than saved. And that, typically, in terms of households, that is typically money that goes to lower and middle-income households who tend to spend a greater share of their income than high-income households who tend to save more.

Mr. SCOTT. And so this tax cut where 80 percent of the benefits went to the top 1 percent and corporations would miss that mark?

Mr. GALE. This tax cut was not well designed to boost short-term consumption, right.

Mr. SCOTT. And how did the tax cut miss? We heard how they missed women businesses. How did they miss small businesses?

Mr. GALE. The small business literature issue is confusing. It is actually young businesses that create most of the jobs. Most of the

small business sector is sort of sleepy and quiet. And just as you would not want to confuse small people and young people, you do not want to confuse small businesses and young businesses. So, what is important is that we generate incentives for young businesses to grow. But if we subsidize all small businesses, we are spending a lot of money without getting a lot of bang for the buck in terms of the economics.

Mr. SCOTT. Ms. Huang, you talked about how the passthrough deduction hurts individual workers. Can you elaborate on that a little bit?

Ms. HUANG. The problem is that it actually might encourage companies to replace good jobs with independent contractors or to outsource those jobs to outside contractors. So, my colleague, Brendan Duke, has research that shows that it risks pushing more workers into low-wage firms or outside the protection of labor laws. So many companies already outsource their janitorial staff, the security guard jobs to outside contractors, for example. But the passthrough deduction gives them a tax incentive to do even more of that.

So, if you were to take a company that was considering whether to retain its in-house IT department or to contract to an outside firm to do that same work, if they contracted to the outside worker, that would get the benefit of a passthrough deduction that they could then split. So that is a tax incentive to go in that direction. Now, that is not really encouraging entrepreneurship or job creation, it is just splitting firms up.

Mr. SCOTT. And what is wrong, why is the worker at a disadvantage as an independent contractor?

Ms. HUANG. Well, in the independent contracting case, there is a lot of research that shows that pay and benefits and legal protections for independent contractors go down. So even though you might get a little bit of passthrough deduction, you could be giving up a whole lot in terms of health benefits, workplace protections and other benefits that usually come on top of wages.

Mr. SCOTT. And, Ms. Bruckner, could you say a word about how we missed small businesses with the tax cuts?

Ms. BRUCKNER. I think that we did not do careful thinking about what type of small businesses we are going to invest in. Women business owners start businesses at rates faster than five times the national average and yet we have never considered if small business tax expenditures generally specifically target and help those women business owners grow. And we do not know if the money we are investing in these business expenditures at all helps these businesses start and grow. And, in fact, my research shows that it bypasses the majority of women business owners who are very small and in services altogether. So, in essence, it could very well be that you are subsidizing the same firms over and over again, as opposed to investing where there is actually opportunity for economic growth.

The absence of congressional research and study on these issues means that you guys are operating completely blind.

Chairman YARMUTH. The gentleman's time has expired. I now recognize Mr. Hern of Oklahoma for five minutes.

Mr. HERN. Thank you, Mr. Chairman, Ranking Member Womack. You know, as a small business owner for the last 34 years, I find it very interesting to listen to testimony of those who actually pay the taxes and those who talk about the tax policy. It is pretty fascinating.

I would like to ask each one of you, I know Ms. Pol has created jobs. Have any of the three of you ever actually had to use the tax code and whichever tax code to actually create jobs, have employees and be responsible and be the last to get paid?

Ms. BRUCKNER. Well, I am someone that is actively looking for opportunities to start my own small business. But my concern over health care cost is precluding me and my husband from starting our own small business. It is something that we are actively concerned about and has delayed. Like most of the literature shows, when you are disproportionately concerned about stability for health care, it delays entrepreneurship.

Mr. HERN. Perfect. You should have been around about eight years ago.

Yes, ma'am, Ms. Huang.

Ms. HUANG. I have not employed people. But I also would like to say that, also in the real world are the millions of workers who receive the paychecks. And I think their voices, including the 11 million kids that get $75 or less from this bill, is also important when thinking about the impacts on the real economy.

Mr. HERN. Sure, absolutely. Mr. Gale?

Mr. GALE. I run a small consulting business and have had people work for me. They were not employees, they were contractors.

Mr. HERN. Fair enough. Thank you. I would like to thank you, Ms. Pol, for all the work you do and being the last to get paid, because anything that happens to expense your business does affect what you take home. And you make sure, as you said, that your employees get paid first and that all your vendors get paid. And that is no easy task, as a small business owner.

You know, your story is fantastic. And fortunately, it is not unique across the country, as many of my colleagues have brought up. Many of my families in Oklahoma's first district benefit from the Tax Cuts and Jobs Act, as well. Today, I would like to highlight 22,000 of those people in my district.

A constituent of mine, Norm S. Bjornson, is the founder of AAON, a Tulsa-based company who engineers, manufactures, markets and sells air conditioning and heating equipment. Norm employs approximately 2,000 individuals at his Oklahoma and Texas facilities. Norm announced personnel employed by AAON on January 1, 2018, excluding executives, will receive a $1,000 bonus in recognition of the new tax reform law.

Additionally, headquartered in Tulsa, QuikTrip Convenience Stores employs over 20,000 people, started in Oklahoma, in Tulsa, in 1961. Fortune has ranked QuikTrip on the list of best companies to work for for 14 years running. QuikTrip also gave their employees bonuses, including part-time employees, and excluding those who are considered executives. QuikTrip also credits the ability to provide these bonuses to the Tax Cuts and Jobs Act. The bonuses range from $500 to $3,000 per employee. Additionally, they are

using savings to grow their company and provide opportunities for their employees.

Finally, as a direct result of the Tax Cuts and Jobs Act, Cox Communications added roughly $450 million, additional dollars, into their employee pension investments to bring solvency to their plan.

You know, I would like to say that, as a direct result of the Tax Cuts and Jobs Act, families in my district ended up with more money in their pockets this year. Small businesses like my own invested over $2 million last year business of the benefits that were brought forth. In addition to the bonuses, added benefits and pay raises, the average family in my district received a tax cut of around $1,888.

And to me, this sounds remarkably better than proposed Green New Deal, which would cost each American family as much as $650,000 per household, we can range from 50 trillion to 93 trillion, whichever number you want to pick. And I also find it very interesting that all of a sudden that our colleagues and the witnesses are talking more about debt after we started putting taxpayer dollars back into people's pockets and no one is talking about Democrat proposals coming from this Congress alone that will cost upwards of $100 trillion, and why are we not holding hearings talking about that, instead of how we are going to spend more.

I yield back my time.

Chairman YARMUTH. The gentleman's time has expired. I now recognize Mr. Peters of California for five minutes.

Mr. PETERS. Thank you, Mr. Chairman. We missed a real big opportunity to do real tax reform. Real tax perform would have promoted American growth and competitiveness. Instead, Republicans chose a path that blows up the deficit and will harm working families in the long run.

And I was at the microphone protesting this move at that time, as were many Democrats. Because debt matters. Debt crowds out private investment. Debt gives us less flexibility to respond to emergencies. Debt increases the risk of financial crisis. And I sincerely hope my colleagues on both sides of the aisle will examine the long-term consequences of ignoring the debt and how this tax bill contributed to this debt crisis.

Mr. Gale, I wanted to ask you, how much did the 2017 tax law increase debt and deficits?

Mr. GALE. Under CBO's dynamic estimates, the full increase in the deficit would be about $1.9 trillion over 10 years. That is for the tax cut as it is written. If the tax cut, if the temporary provisions were extended, the net debt, deficit effect would be over $3.1 trillion.

Mr. PETERS. Right. And someone suggested that these were static analyses. Can you describe briefly what you mean by dynamic in that context?

Mr. GALE. Sure. Static, what is called a static analysis incorporates a lot of behavioral responses, but it keeps the macroeconomic aggregates constant. So, it keeps output constant but it allows people to shift, for example, between different types of saving if it were a proposal to increase IRAs or something like that.

A dynamic estimate is also called a macro-feedback estimate. It includes the impact on the economy, as well as then how that feeds back into revenues, as one of the congressmen was discussing. So, it incorporates all of those effects.

Mr. PETERS. Fair to say it is a more comprehensive view to do dynamic than static?

Mr. GALE. Yes, absolutely.

Mr. PETERS. Even after the law passed and independent groups scored it as increasing the deficit by nearly $2 trillion, the administration claimed that it would pay for itself. Secretary Mnuchin claimed, "So we are humming along on where projections are and, as I have said, at 3 percent economic growth, this tax plan will not only pay for itself but in fact create additional revenue for the government."

Mr. Gale, is there any evidence to support this claim?

Mr. GALE. No. There is, in principle, a growth rate at which the tax cut would be revenue neutral. But no one from the CBO to the JCT to Mark Zandi who was mentioned earlier, to the Tax Policy Center, to others, nobody predicts that the economy will grow at that rate.

Mr. PETERS. If I recall, it was something around over 4 percent was the assumed rate at best case?

Mr. GALE. I believe that's right.

Mr. PETERS. And again, as you said, CBO shows that the tax bill, even if some provisions expire on schedule, will add $1.9 trillion to the debt by 2028 and that extending it this year would cost at least another $1.1 trillion through 2029.

You know, people like to take a shot at my home state of California and their relatively high tax rates. I would just say that growth in California has been pretty strong. Do you agree with that understanding?

Mr. GALE. Yes, the economics literature is pretty clear on this. There is a very weak relationship between state growth rates and state tax rates.

Mr. PETERS. Right. I would also note that in Kansas, where there is a huge effort to cut taxes as unprincipled as this effort in Congress in 2017, voters wised up and removed the governor because they wanted to see public investment. And public investment now is at a relatively low historical level for the United States of America. And if we wanted to encourage economic growth, and I hope we will discuss that in this committee, that would be something we would want to consider to invest in.

Finally, Mr. Gale, when you give tax cuts, when you potentially debt finance tax cuts like we did in 2017, is it fair to say that the growth impacts are less than debt financing something like infrastructure?

Mr. GALE. I think in general, yes. It depends on how the tax cut gets used. But if a significant percent of it gets used simply to be spent, whereas if 100 percent of the infrastructure gets focused on new investment, then the infrastructure investment will have a bigger impact.

Mr. PETERS. Well, on trade and on things like the deficit, I invite Republicans back to their roots and hopefully we will have that discussion.

Chairman YARMUTH. The gentleman's time has expired. I now recognize Mr. Smith of Missouri for five minutes.

Mr. SMITH. Thank you, Mr. Chairman. I appreciate the opportunity to have this hearing, for us to highlight the benefits of the Tax Cuts and Jobs Act.

I am reminded of a gentleman from my home state, Mark Twain. Mark Twain had a quote that said, you can't depend on your eyes when your imagination is out of focus. That is what I am reminded by so much of the conversation that I have heard sitting on this panel today.

As one of the original co-sponsors and writers of the Tax Cuts and Jobs Act, there is a lot of not serious conversation when we are talking, first off, about the statement of a $1.5 trillion debt over 10 years or a $1.9 trillion of debt over 10 years to pay for the Tax Cuts and Jobs Act, whenever more than half of my colleagues on the other side of the aisle have signed onto House Resolution 109, the Green New Deal, which reports showed yesterday would cost $94 trillion, $94 trillion. That is $9.4 trillion a year and you all are saying that we are exploding the debt over $150 billion that we allow American taxpayers to keep of their money, not the government's money, of their money.

So, my question is, to the other side, actually, is when you are proposing 12 Democrat colleagues of mine on that side of the aisle have co-sponsored the Green New Deal, who want to add $94 trillion, this is what we are dealing with on the budget committee, people that are not—not being realistic.

What I will say is I represent one of the poorest congressional districts in Congress, maybe the poorest on this committee. The median household income in my district is $40,000 a year of a family of four. Southeast Missouri. And I can tell you that, Mr. Gale, your judgment when you look at things of whether it is the wrong thing at the wrong time in your opening statement, well I will tell you the young lady who got a very nice, sizeable bonus at Lowe's in Rolla, Missouri, when I met with her because of the Tax Cuts and Jobs Act, she was able to purchase a new car seat for her toddler because her old car seat was broken. That was at the right time, it was not at the wrong time, and it was for the right person.

I can talk to you about the bank teller in Hartville, Missouri, who told me that U.S. Bank, because of the Tax Cuts and Jobs Act is now paying all their employees at at least the starting wage of $15 an hour. That is real money in Wright County, Missouri.

I can tell you about the individuals at the call center in Cape Girardeau, Missouri, that received a $1,000 bonus from AT&T because of the passthrough of the Tax Cuts and Jobs Act, and the savings that they were able to pay for their kids' college books. That is real, real money.

$850 in southeast Missouri is not crumbs. To some politicians in San Francisco, California, it is crumbs. But where they make their median income household of $40,000, that is a couple months' rent, that is a couple car payments. So, unless you have been to the bootheel of Missouri and you see what my people are experiencing, don't you say that the people of southeast Missouri have not benefitted.

We see a growing economy. Right now, we have the largest increase in wages in over a decade. CBO said that. CBO predicted more than 900,000 new jobs over the next 10 years. These are facts.

Mrs. Pol, thank you for being here. And I also want to thank you, the very last line in your statement, you encourage Congress to pass the Main Street Tax Certainty Act. I am with you, that is my legislation. So, thank you for highlighting that. And that causes real growth for small businesses.

And Ms. Bruckner, I hope that you have the opportunity to open up your small business. And I don't know why you were not able to do it after the Democrats passed Obamacare, because we have not changed health care from when they did until last year. And when you look at the CBO report, they predicted that by eliminating the mandate, it would take 14 million people off. But CMS just reported that it is 2.5 million people that chose not to purchase health care because they could find it cheaper somewhere else.

With that, Mr. Chairman, I yield back.

Chairman YARMUTH. The gentleman's time has expired. I now recognize Mr. Horsford of Nevada for five minutes.

Mr. HORSFORD. Thank you, Mr. Chairman. And first I would like to start by saying, being an advocate of small business is not a partisan issue. Coming from my district, Nevada's fourth district, I work very closely with my small business community, the metro chamber, the urban chamber, the Latin Chamber of Commerce, the Asian chamber. I, myself, am a small business owner and have helped to create jobs. And so, to suggest somehow that this is a partisan issue, I just do not ascribe to that thinking.

But what is a real fact is that the tax scheme that was passed by the prior Congress gave a temporary tax benefit to small business but gave a permanent tax break to big corporations. So, while we have these slides today showcasing a number of small businesses by my colleagues in their district which we fully support, I guess the question would be why was there not advocacy for them, to make their tax break permanent instead of temporary?

My question is related to the facts and not fake news, is since last year, corporate profits have increased by 13 percent from already near record high levels. So why did we give permanent tax cuts to big corporations and not help more small businesses so that you could predictably plan for the future and hire more people? Why did they approve a tax plan with no public hearings in 51 days and not take into account the fact that, again, according to the recent data available, wages are essentially flat since the passage of this tax bill?

So Ms. Huang, the tax law delivered the largest tax breaks for the wealthiest households, specifically corporations. Many analysts predicted that because most of the benefits flowed to the richest taxpayers, economic inequality would increase. Can you briefly elaborate on how the tax law worsens economic inequality as well as wage stagnation?

Ms. HUANG. Absolutely. I think you are absolutely right, I think we would like to, I think proponents of the law would like us to picture family-run, Main Street businesses who are actually investing and increasing wages. But the fact of the matter is, the bulk

of the dollars are hitting to, you know, the big banks that are posting record profits, the private equity firms that are reorganizing as corporations in order to get the corporate tax cut, the pharmaceutical companies that are getting big tax cuts without passing that on to their consumers or investing in the U.S.

So overall, following those decades and decades of a larger share of the nation's income going to the top 1 percent, this tax law worsened that by giving bigger tax cuts to the very top than to people at the bottom and in the middle. And that in turn, as I mentioned in my opening, feeds racial inequities as well.

Mr. HORSFORD. Thank you. Another point I want to touch on is the reality, again, real facts, that millions of taxpayers are now beginning to file their tax returns. And I received a note from a constituent, Kevin, from Las Vegas, Nevada, who wrote to my office and told me this is the first year that my husband and I are filing married jointly. Our joint refund, which should be in theory have been higher than we filed as single, since we both still deduct at the single rate. The GOP tax plan touted benefits for married couples making over $120,000 per year. But when we looked at the tax filing process, removing the married status and deduction, we would have ended up owing the government several thousand dollars more.

Can either of you speak to the reality that millions of Americans are now going to owe more in their upcoming tax filing because of the GOP tax scheme that was passed last Congress?

Ms. HUANG. I think there is undoubtedly a lot of confusion around refunds and total tax liability. And that has not been helped at all by the rushed enactment and implementation of the tax law, along with some of these overblown promises that we have heard before. And I think overall, we are hearing a lot of evidence that the public knows that the law overall is tilted toward the highest income filers.

I think one of the key examples that I have seen of the misapprehension about what the law does is the repeated statements, for example, from President Trump and Ivanka Trump and Secretary Mnuchin about what families with children would get, this $2,000 increase in their refunds or their child tax credit. When, in fact, 11 million children in the lowest income families will get $75 or less and millions more will get far, far less than the full $2,000 refund.

So I think going forward, what we want to do is to actually fix that and prioritize those families so that they can see something of an improvement in their living standards.

Mr. HORSFORD. Thank you, Mr. Chairman.

Chairman YARMUTH. Thank you. The gentleman's time has expired. I now yield five minutes to the gentleman from Georgia, Mr. Woodall.

Mr. WOODALL. Thank you, Mr. Chairman. Thank you for those five minutes. I do not know if you are going to go around for a second round of questions. I find when I want to spend my first four and a half minutes making a point, it is tough to get to the good witnesses after that.

I had something of value across the board. Ms. Pol, I wanted to start with you. Did it ever dawn on you when you thought about what Congress was doing as we were trying our very best to get

good tax policy that, when you read about those committee hearings, that it would be one witness from one side of the aisle and then maybe three witnesses or more from the other side of the aisle, or did you think that it was not a stacked deck but an even playing filed, just from a distance back home?

Ms. POL. No, I would not have expected that.

Mr. WOODALL. I would not have either, and it is certainly the way we ran the place when we were running it and it is the way it is now and I think that is a shame on some issues like this. I heard you say specifically you made different business decisions, positive business decisions for your employees because of the passage of the tax bill.

I heard other witnesses say unequivocally that they worried employees were disadvantaged not by the tax bill in general but specifically because of those passthrough provisions that were targeted at your business. And that is a legitimate concern. Everybody cares about employees. Do you have a more valuable resource in your business than your employees? Can you just go out and find new talent if you lose the talent that you have today?

Ms. POL. No, absolutely not. We have some specifics with truck drivers, especially. I just lost one to a death. I am going to have a hard time finding somebody in that position and they are valuable. We welcome them to the Geetings family when we hire anybody because that is what they are, they are our family and they are our salespeople.

Mr. WOODALL. Not surprisingly, Dr. Gale made a good point when he distinguished between small businesses and young businesses. It is not about maintaining a business model that is failing, it is about growing a business model and providing more opportunity in the community. Not to put you on the spot, we have not talked about this. You come from a serial entrepreneur family. Would you describe yourself as a small business or as a young and growing business?

Ms. POL. I would say we are young and growing yet. We are looking forward to more expansion.

Mr. WOODALL. I think of one of my constituent companies, Boehringer Ingelheim. It is a family-owned business, started in 1885. They have been a young and growing business since 1885. It is now a multinational company. They can do business anywhere in the world they want to do business. They just brought an additional 225 jobs to Georgia. This is an animal health sciences company. These are high-paying jobs. This is not a $15-an-hour job, which is a great job to get. These are six-figure jobs that could have gone to Europe, could have gone to Asia and are coming to America instead, because folks have a choice. Multinationals do have a choice.

If you wanted to pick your business up and move it to Europe or Asia, I suspect that would be a much more challenging model.

I want to think about the women-owned businesses that Ms. Bruckner referenced. She is absolutely right, we crafted the tax code to focus on capital-intensive businesses because, and Dr. Gale may be able to speak to this, because we believe that capital-intensive businesses had a higher multiplier effect. But, yes, more small businesses are service-oriented businesses.

When you think about your peers in leadership back home, have you heard that concern before? Folks who said, golly, those capital-intensive small business owners did get a special break that I did not get in my service business?

Ms. POL. I am not really hearing as much of that, at least in Iowa. I also belong NAWBO, National Association of Women Business Owners. And so, I have been active in that for a while. And a lot of what we are finding is, when we are building, when the large companies are building, when we are building small businesses, we actually use their services. And so, you know, I think it is helping out all the way through.

And of course, we are looking at—I look at using women business owners, and I support that.

Mr. WOODALL. Candidly, I have not read the Billion Dollar Blind Spot. I am now going to have to think through that, because I thought that was a perfectly legitimate criticism. And I wish, Mr. Chairman, we had more time to actually talk about individual improvements. What Dr. Gale said about generational inequities, I think that is critically important that we talk about. You know, Dr. Kotlikoff has talked about that on a regular basis in terms of how we measure tax input.

And one thing that I would like to get us to get back to, Mr. Chairman, lots of talk about consumers and lower income families being the stimulative effect in a tax cut. Certainly, that is true. Except the Tax Policy Center reports that the bottom quintile, bottom 20 percent, is paying a negative tax rate today for income taxes. About the bottom 40 percent are paying a negative income tax rate today. I would be interested to come back and have the conversation. Of course, those dollars are stimulative. Should we do it through the tax code or should we do it through the income support spending level? I am one of those, Dr. Gale, as you are, that believe tax expenditures should be measured as spending programs, not as tax programs, and we have not accurately measured those in the past, Mr. Chairman. I look forward to that partnership.

Chairman YARMUTH. Thank you for the idea. We will consider that. I thank the gentleman. I now recognize Mr. Panetta from California for five minutes.

Mr. PANETTA. Thank you, Mr. Chairman, Ranking Member Womack. I appreciate this opportunity. And to all the witnesses, thank you for your time and your preparation, not just for this hearing but what you have done to be at this hearing. So, thank you very much.

I am going to pick on Mr. Gale if that is all right. Just a couple questions for you, sir. And I am sure you were probably aware of this and you probably watched this hearing. But before the tax law was passed, you had a number of senior administration officials come actually into this committee and talk about the tax law and what they attempted and what they wanted to pass. And one of them was Mick Mulvaney and I am sure he was, at that point, OMB or one of his many positions. I think it was OMB at that point.

And he said, when he testified in front of this committee, "We assumed for the sake of doing the budget that the tax plan is deficit neutral, that removing the exclusions, the deductions, the loop-

holes would lead us to a deficit-neutral tax plan. The dynamic benefit is only counted one time and that is toward the 3 percent economic growth, and I am happy to explain that further to you if you like."

What I would like for you to explain, Mr. Gale, have these tax cuts been deficit neutral?

Mr. GALE. Every reputable organization that has looked at this has found that the tax cuts, lo and behold, reduce revenues. And that is including the macro feedback effect. And that is a very wide range of organizations. The Congressional Joint Tax Committee, the Congressional Budget Office, think tanks like the Tax Foundation and the Tax Policy Center, private modelers, everyone comes to the conclusion that the tax cuts will reduce revenues.

There is, in theory, a growth rate that would be fast enough to offset all the revenues. But nobody thinks we are going to be anywhere near that growth rate.

Mr. PANETTA. In theory, what is that?

Mr. GALE. It is above four. I am not sure exactly what the right number is. But it would be great if we could grow at that rate. But, and this comes back to the comments about imagination and the anecdotes earlier. The anecdotes are inspiring and we should all, you know, be moved by our imagination. But there is no substitute for serious analysis.

Mr. PANETTA. Understood, understood. I guess in discussing analysis, I guess the CBO has done, you know, obviously many analyses on this. And it has showed that the tax bill, even if it does expire on schedule, it will add 1.9 trillion, I think they are saying, to the debt by 2028, with interest and growth, obviously. And extending it this year would cost at least, I think, another 1.1 trillion through 2029, what they are saying.

Mr. GALE. Right.

Mr. PANETTA. In your opinion, Mr. Gale, and if any other witness would like to speak to this, can we afford $3 trillion worth of tax cuts in this type of strong economy that we are experiencing right now?

Mr. GALE. There are two issues here. One is the size of the tax cuts and the second is the allocation of the tax cuts. The size of the tax cuts are substantial. It is in the wrong direction as far as long-term fiscal sustainability is concerned. But if we had allocated the money really well to pressing national needs, then it might have been worth it to increase the deficit by that much.

But TCJA basically says the biggest problem in the country is that high-income households do not have enough after-tax income. And so, it is allocating an enormous amount of that increase in deficits toward high-income households. Now, all of the stuff about people buying a car seat or getting a job or getting other benefits, those are inspiring and we should be doing that. But this is an incredibly poorly way to target those benefits. We do not have to pay off the top 1 percent of the population to give benefits to the bottom half.

Mr. PANETTA. And, I think Ms. Huang, you are shaking your head.

Ms. HUANG. In vehement agreement. And I think the other part that Dr. Gale has also talked about is who ends up holding the tab

for those tax cuts for the very top. And we have seen over and over again in both the statements and the budget proposals of people who supported the 2017 tax law that their preferred way of dealing with deficits is to cut programs that, you know, on average help families of limited means, Medicaid, cuts to job training and assistance, education programs. So that is also another worry that I think is part of the picture.

Mr. PANETTA. Thanks again to all of you. I yield back, Mr. Chairman. Thank you.

Chairman YARMUTH. I thank the gentleman. I now recognize Mr. Crenshaw of Texas for five minutes.

Mr. CRENSHAW. Thank you, Mr. Chairman. Thank you all for being here. I want to thank all our witnesses again.

And I want to remind everyone what we are really here talking about. We are talking about a difference in philosophy. It is not just tax rates. It is a question of whether the government should be taking more of your money or whether you should keep more of your money. It is a difference in the role of government in what we believe.

It seems to me that you all believe that the role of government is to tax the people as much as possible so that you and your benevolent fellow academics can dream up more programs for the government to spend money on. I don't believe that. I don't believe that is what the role of government is for. The role of government is to protect the God-given rights that we have and to ensure that we live as free as possible.

The role of government is to tax people to the least extent possible while still taxing them enough to cover basic needs for government. And if we are questioning what those needs are, we can just look at our Constitution. They are generally pretty clear there. So that is what today is about.

You said that these anecdotes are imaginative. It is literally not imagination to bring up anecdotes. It is literally not that. It is reality. So here is some reality from Texas. Direct results from the Tax Cuts and Jobs Act.

McDonald's increased educational opportunities by $150 million as a result of the tax cuts. $500 employee bonuses at Camp Construction Services. Reduced prices for customers at Center Point Energy. $500 employee bonuses at Group One Automotive. $1,600 employee bonuses at Cabot Oil and Gas. $2,000 employee bonuses at Waste Management. $1,000 to $4,000 bonuses paid to employees at Insperity, totaling 17 million. Base wages raised to $15 an hour at Cadence Bancorp along with an increased 401(k) contribution and employee stock purchase plan. Covestro had a choice between three new facilities, a $1.7 billion facility, between Asia, Europe and Houston, so they chose Houston and they say it is directly because of the tax cuts.

These are not imaginative anecdotes. These are real. You said it, so——

Mr. GALE. I said the anecdotes were inspiring.

Mr. CRENSHAW. I did not ask. That is okay, that is okay.

There is more money in the pockets of the people. That is the reality, okay? Not imagination.

Professor Bruckner, again, we are speaking about imaginative arguments. You acknowledge that there is a direct benefit of the tax cut to people across all incomes but you are claiming that women do not benefit as much. Is that correct, yes or no?

Ms. BRUCKNER. No, I am claiming that we absolutely should study this for the first time ever, to determine what the impact is.

Mr. CRENSHAW. Okay, but would you prefer another tax cut for women entrepreneurs? Because we might find some common ground there.

Ms. BRUCKNER. No. What I am saying is we should take a look at JCT's analysis and we should coordinate among our government resources to study where the distribution of the income is. Are we investing in where there is actual growth and opportunity for growth? Are we investing in businesses that will generate more economic activity?

Mr. CRENSHAW. Fair enough. But on the health care issue, you took issue with the changes to the individual mandate. What we have gone over is that those estimates of people, quote, unquote losing their health care, of course, it is not losing your health care, you are choosing a different health care plan. Do you not believe in giving people that choice?

Ms. BRUCKNER. I believe in creating schemes that provide a pathway for affordable health care for small businesses. It is their number one concern.

Mr. CRENSHAW. Obamacare hurt small businesses, as we know. And I just want to point out, the law gives people the choice. They are not losing something, they are choosing something else, and I have got to move on because I have such limited time.

Ms. Huang, you took issue with the 20 percent tax cut for small businesses. You are claiming that that leads to lower workplace standards, that it encourages independent contracting. Do you not believe that small businesses also deserved that tax cut?

Ms. HUANG. So, let's look into what the definition of a small business is. If you look at where the revenue went——

Mr. CRENSHAW. Yes or no? You do not want them to take that 20 percent tax cut?

Ms. HUANG. More than two thirds of the tax cut for passthroughs went to the top 1 percent. Those are not businesses that I would consider small.

Mr. CRENSHAW. Okay, let's talk about the 1 percent. What is the fraction of total federal revenue the top 1 percent paid?

Ms. HUANG. What is the fraction of income that the top 1 percent gain?

Mr. CRENSHAW. That is not the question. You cannot answer it? All right, well, I will tell you what it is. It is around 37 percent, according to recent IRS data. Is that fair?

We talked about passing the fair test. So, the top 1 percent pays more than the bottom 90 percent. Is that fair? And again, we have different definitions of fair.

Ms. HUANG. I don't think it is fair to cherry pick one type of tax——

Mr. CRENSHAW. Again, we have—you guys have been cherry picking this whole time.

Ms. HUANG.——when other people pay payroll taxes, state taxes——

Mr. CRENSHAW. I am not done. I am not done, because I only have 10 seconds left so I am going to use it to make a point here. We have different definitions of fair. And that is okay. But I wish we were honest about that. You believe fair is proportionality or, sorry, I believe fair is proportionality; you believe fair is egalitarianism. We have different approaches to governance and that is really what this is about. And I hope we have honest conversations in the future. Thank you.

Chairman YARMUTH. Just to set the record straight, Dr. Gale did not use the word imaginative, he called those inspiring. Actually, the imaginative came from quoting Mark Twain by Mr. Smith.

I now recognize Ms. Omar for five minutes.

Ms. OMAR. Thank you, Chair.

Ms. Huang, thank you for your forthcoming testimony about the impact of the GOP tax cut to the American people. The details you shared were very insightful, though the underlying message you are sharing should not be a surprise to anyone here. Clearly, the 2017 tax cuts were just a tool that our Republican colleagues used to help make their rich friends richer.

As you illustrated, everyday working Americans have not seen a dollar of the benefits that the Republicans and the Trump administration promised them. So, promise is something that came up quite a lot and I want to just go through some of those promises.

There has not been any meaningful growth, wage growth, as they promised. We are not seeing millions of jobs added to the economy as a result of the cuts as they promised. We are not seeing a major economic boost, certainly not one that offsets the revenue decreases we are now facing, as they promised.

What we are seeing is a record $1 trillion in corporate stock buybacks. What we are seeing is major corporations like Amazon, a company that is valued at $800 billion, paying exactly zero dollars in taxes. So, what is happening right now is we are paying off, as Dr. Gale said, we are paying off the top 1 percent on the backs of the rest of us.

So, these promises have been made. All the while, the American workers are trying to balance a skyrocketing health care cost, mounting student debt load and impossible high child care costs. Where are their benefits and where are their promises? These tax cuts are not helping them pay those bills. In many cases, workers are seeing their wages go down while everyday cost goes up.

So, my question to you is, giving everything that you have shared in your testimony, does the GOP tax cut do anything to improve the lives of everyday working families, families like the ones in Minneapolis, families like the ones in everyone's district that we have heard about?

Ms. HUANG. They are not, in my view, the priority of this tax law. I think actually something has gone seriously wrong when you have a $1.9 trillion tax bill and there are a single mother with two kids working full time minimum wage who gets $75 from this law and there are 11 million kids and working families just like her.

So, to really fix this and prioritize those working families, we could have and should have seen a substantial increase in the child

tax credit and earned income tax credit for those working families. And that should be the first thing that lawmakers prioritize when fixing this law.

Ms. OMAR. Thank you. And my colleague from Texas talked about rights earlier. I believe we have a right to breathe clean air, we have a right to have access to clean water, we have a right to have a planet we can live on. And a lot of my colleagues on the other side of the aisle talked about the Green New Deal. The Green New Deal is one that has economic growth and opportunity.

A recent op ed on the Hill called the Green New Deal is Good for the Economy states that, while the Green New Deal is not going to be cheap, it is pale in comparison to the damage that unchecked climate change will inflict on the economy.

Can you speak to what the costs would be if we are not investing in making sure that we have a planet we can live on?

Mr. GALE. Thank you. The right question about the cost of the Green New Deal is compared to what? If we are truly on an existential descent, then we should be doing a lot to try to offset that. That does not mean—that is not carte blanche to do anything. We should be choosing the most effective interventions and most cost-effective interventions.

But just as the congressman was talking about imagination earlier in respect to the tax cuts, we should be moved by the potential to make the planet a cleaner place. Again, that should not substitute for analysis of what works and what is the best way to do it. But the goals and the ambition that are laid out I think are exemplary.

Ms. OMAR. And through taxes and subsidies we could have economic growth and opportunity with the Green New Deal is what——

Mr. GALE. Again, compared to what? If climate change, you know, has increasing costs over time, then mitigating that climate change, we should get credit for that in terms of looking at the economic effect. So, yeah, I think there is a positive outcome there.

Ms. OMAR. Thank you. I yield back.

Chairman YARMUTH. The gentlelady's time has expired. I now recognize the gentleman from Pennsylvania, Mr. Meuser, for five minutes.

Mr. MEUSER. Thank you, Chairman, very much. And thank you, our guests here today, for your testimony. I—first off, I represent a district, the PA 9th, where the median income is $43,000. I don't represent the rich. Secondly, as the former revenue secretary for the Commonwealth of Pennsylvania, I can assure you that Amazon pays a lot of taxes. A lot of tax revenue comes in from Amazon.

I think earlier, my colleague's main point that you guys wanted to try to minimize was about honesty and trying to get to the truth. I think that that would be a honorable baseline to have a good conversation here with the budget committee that understands the budget and the numbers.

So, I am certainly a little confused, call it frustrated, with what I am hearing today from my friends on the other side of the aisle. What has been wrongly argued as the Tax Cuts and Jobs Act is responsible for this current budgetary deficit, first of all, is inaccurate. Right? The number is $150 billion and closing fast, by the

way. And it is also inaccurate to say that this was purely a tax cut for the wealthy at a cost to the middle class. This could be nothing further from the truth. It is simply inaccurate and is not focused on reality and facts.

The facts are middle income taxes were reduced by 3 to 4 percent. The standard deduction doubled. I am not sure if you know what that means but $12,000 no longer is taxed of people's income. Small business did receive a 20 percent reduction. Seventy-five percent of the people employed in my district work for small businesses. This was very important. Unemployment nationwide is lowest since 1969 in all demographics.

Corporate taxes, we want to sit here and beat up on corporations. Corporations buy most of the product from small businesses. They work together. Our corporate tax, yes, it was reduced to 21 percent. However, if you are aware of this, Ireland's corporate tax rate is 12.5 percent, the U.K. is 19 percent and Vietnam is 20 percent. We have to be competitive. And that is what is creating more investment and more manufacturing in our country, and it is happening. And the repatriation, everybody just scoffs at that, it is getting near a trillion dollars. It just does not happen overnight.

So, the goals of the tax cut are real. And, you know, I can't help but shake my head when I hear about all the woes and sorrowfulness of the deficit. You know, we spent eight years where there was $9.5 trillion spent and none of my friends on the other side of the aisle said a word about it. And, frankly, what do we have to show for it? Not much, not much.

So, thanks to the tax cuts that were signed into the law last year by Republicans, not one Democrat voted for it, businesses large and small are increasing wages. That data is in, too. They are hiring more workers, they are investing in growth.

There are many, many good American business stories in my district. Every day, I hear from a contractor or a builder or a store that tells me that they are doing better.

Can we do better? Absolutely. That is why I am in Congress, to help that effort, to help create a more competitive environment.

Government's role is not to create jobs. Government's role is to create an environment where the private sector creates the jobs and drives disposable income and overall incomes of the people.

I want to give an example of one success story in my district. It is a company in east-central Pennsylvania by the name of Ashland Technologies. I asked them if we could speak on their behalf and they were very excited at that prospect, because they are very proud of what has been done. Thanks to the tax reform, AshTech was able to open a new manufacturing facility, hire 20 new workers and purchase nearly $2 million in new equipment thanks to the 100 percent depreciation, just in the last couple of years. This is an area where unemployment—good paying jobs, we needed impetus such as this.

So, I have a question for Ms. Pol. Ms. Pol, would you say that your business record over the last several years has been similar to the one that I referred to as from AshTech, hiring, expanding?

Ms. POL. Absolutely.

Mr. MEUSER. That is great to hear.

And with my last couple of seconds, can you provide any recommendations as to further tax changes that would benefit a business such as your own?

Ms. POL. Well, in our business one of the ones that would be great is the depreciation on buildings, because I have so many of them. You know, it is over 39 years, and that is a long time to depreciate out a building. So that is one that kind of relates to me.

Mr. MEUSER. Great. Thank you for your testimony. Thank you, Chairman. I yield back my time.

Chairman YARMUTH. Thank you. The gentleman's time has expired. I now recognize the gentlelady from Illinois, Ms. Schakowsky.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman. I ask unanimous consent for us to put into the record a one-pager from the Center on Budget and Policy Priorities called 2017 Tax Law's Passthrough Deduction Could Encourage "Workplace Fissuring."

Chairman YARMUTH. Without objection, so ordered.

[The information follows:]

Center on Budget and Policy Priorities | off the charts | POLICY INSIGHT BEYOND THE NUMBERS

2017 Tax Law's Pass-Through Deduction Could Encourage "Workplace Fissuring"

DECEMBER 20, 2018 AT 12:45 PM

BRENDAN DUKE
TAX POLICY ANALYST

As our new report explains, the 2017 tax law's deduction for "pass-through" income may contribute to "workplace fissuring" — when firms obtain the services of workers such as truck drivers or janitors without hiring them directly, often paying them less and in turn contributing to growing compensation inequality. In their rush to enact the law, President Trump and Congress ignored that risk to workers, and it's yet another strong reason why policymakers should repeal the deduction.

The law provides a 20 percent deduction for certain pass-through income — income that owners of businesses such as partnerships, S corporations, and sole proprietorships report on their individual tax returns, which previously was taxed at the same individual tax rates as their wage and salary income. The deduction results in a lower tax rate for certain business owners (including independent contractors) than for traditional employees, which encourages workplace fissuring in two basic ways.

First, it provides a tax break to workers hired as independent contractors, so employers can use it to entice new hires to accept positions as contractors instead of traditional employees. But the drawbacks for those contractors could outweigh their tax gains, as many disadvantages of independent contractor status for workers are advantages for employers. Independent contractors don't enjoy legal protections regarding the minimum wage, overtime, sexual harassment, and workplace safety; they typically don't get employee benefits such as health insurance that employers often provide to employees; and they must pay both the employer and employee shares of payroll taxes. Employers also have an incentive not to disclose these drawbacks to their employees or to understate them relative to the deduction so that independent contractors won't try to negotiate higher pay to make up for them.

Second, the pass-through deduction could further encourage firms to rely more on contracting firms and franchises. Consider a lead firm deciding whether to retain its in-house IT department or hire an outside contractor firm to do the same work with the same management structure. The owner-managers of the contractor firm qualify for the pass-through deduction, but the in-house managers don't. The contractor owner-managers can therefore charge the lead firm less while doing the same work for the same take-home pay as the in-house managers, enticing the lead firm to choose the contractor option.

Similarly, a firm may choose not to open a "branch" (where it employs a manager and workers) and instead expand with a "franchise" (in which the owner-manager owns the establishment and pays royalties to the original firm, and the remaining profits are eligible for the deduction). That way, the firm can effectively pay the franchise owner less than a manager without reducing the owner's after-tax income.

As for rank-and-file workers, they would remain traditional employees whether they worked for the contractor firm or franchise or the lead firm. If they worked for the contractor or franchise, however, they might receive lower pay and fewer benefits. Outsourcing reduces wages by 4-7 percent for janitors and by 8-24 percent for security guards, while reducing health insurance benefits for both, economists Arindrajit Dube and Ethan Kaplan found. Other studies have found similar results. These workers also may have fewer chances for training or career advancement. In addition, labor-law violations are more common at franchise restaurants and hotels: franchise-owned fast-food restaurants were 24 percent likelier to violate labor laws than those owned directly by the lead firm, and the back wages they owed workers were 50 percent higher per violation, an analysis found.

The 2017 law's supporters may say that the pass-through deduction's incentives for workplace fissuring encourage entrepreneurship, with individuals creating more contractor firms and opening more franchises. And, on paper, the deduction could create a large number of new businesses. But that's not the type of entrepreneurship that spurs

innovation and job creation — instead, firms would merely be breaking themselves into pieces and creating new types of entities to generate tax savings.

In short, the new pass-through deduction moves tax policy in the wrong direction. It may push more workers into low-wage firms or put them outside the protections of labor laws, while depressing wages and weakening employer-provided benefits and workplace standards. That's one more reason that policymakers should undo this serious policy mistake and repeal the pass-through deduction.

Ms. SCHAKOWSKY. Let me just say to my colleagues, I really do not think we ought to get into only you are telling the truth and we are not. We may have different interpretations of the data. But the idea that somehow, we are not telling the truth, we are not dealing with facts, I think is a dangerous place to go and unnecessary.

The White House Council of Economic Advisers said the 2017 tax law would raise the average worker's wages by $4,000 to $9,000, claiming the main wage suppressant over the last 40 years, when their economic policies have been enacted, has been international competition in terms of low tax rates.

Instead though, what we have seen are companies investing more than $1 trillion in stock buybacks. That is over 130 times the $7.1 billion corporations have given workers.

Dr. Gale, have workers seen $5,000 more, somewhere around there, in their paychecks as a result of the Tax Cuts and Jobs Act?

Mr. GALE. There is certainly no evidence to date that workers' gains have been anything near the 4,000 to 9,000 that the CEA claimed would occur. It is unclear from the CEA's analysis what the time frame for their analysis is. But as I noted earlier, CBO says that national income will only go up by 0.1 percent after 10 years because of the tax cut.

This is facts and analysis, by the way. And it is hard to see how wages would go up by the 4,000 to 9,000 above what they would have gone up anyway if national income is only going to be 0.1 percent higher than it would have been anyway.

Ms. SCHAKOWSKY. Does not add up, does it? So, let's look backward here. Ms. Huang, did the wealth trickle down to workers in the form of wage increases after the 2003 Bush tax cut?

Ms. HUANG. The historical record is pretty poor on that.

Ms. SCHAKOWSKY. So, Dr. Gale, did the wealth trickle down to workers in the form of wage increases after the 2001 Bush tax cut?

Mr. GALE. The 2001 featured both similar cuts to 2017 income tax rates and estate tax rates, and then there was the repatriation holiday a couple years ago. Wage growth was fairly slow in that period. You certainly do not see a big boost in worker compensation at that point. In particular, in the repatriation, there is strong evidence that firms—if you recall, the law then said that firms could not get the tax holiday for the repatriation unless they invested the money—they could not get the holiday if they used it for dividends and buybacks. But subsequent evidence shows that the firms that got the subsidy used it for precisely those reasons, dividends and buybacks, rather than job expansion.

Ms. SCHAKOWSKY. Was that in the law, that they were supposed to——

Mr. GALE. That was a provision in the law back during the Bush administration, yes. Of course, money is fungible, so they basically said, well, this money we brought back we are going to pay to workers. But this other money which we used to be paying workers, now we are going to pay out to shareholders.

Ms. SCHAKOWSKY. I see. Ms. Huang, are you aware if the wealth trickled down to workers in the form of wage increases after the 1981 Reagan tax cut?

Ms. HUANG. No, and you can look back at many different examples including that one, including the experience in Kansas, and there is very little evidence that these tax cuts for high income people and large businesses end up in workers' wages over time.

Ms. SCHAKOWSKY. So I guess in general, I am asking both of you if there are any examples that you can find that trickle down? That is, cutting taxes for the wealthiest Americans has actually improved the lot significantly then, or equally, of ordinary working families. Dr. Gale?

Mr. GALE. Thank you. My reading of the literature is there is an enormous amount of evidence, whether it is cross-country evidence or historical evidence in the U.S. that says that trickle-down economics falls far, far, far short of what is claimed for it.

Ms. SCHAKOWSKY. Thank you, I yield back.

Chairman YARMUTH. The gentlelady's time has expired. We have one more Republican who is on his way back to testify so if the ranking member agrees, we will yield to Mr. Sires for his five minutes and then——

Mr. WOMACK. Absolutely.

Chairman YARMUTH. Oh, here is Mr. Burchett.

Mr. BURCHETT. Go ahead, go ahead.

Chairman YARMUTH. All right, Mr. Sires, you are recognized for five minutes.

Mr. SIRES. Thank you, Mr. Chairman. And thank you for the witnesses that have been here today.

Look, I am from New Jersey, a very high-tax state. We probably got hit harder than any other state with this tax bill that was passed last year. I am very concerned about what is happening in terms of the real estate market and how it is impacting the real estate market.

You have people in my—well, my district is across from New York City. We get the overflow from New York City. They are high wage, they make good salaries, they come to New Jersey and they pay a lot of taxes, especially in the real estate market. New Jersey benefits greatly from that.

I am starting to get a lot of questions from these people who are making good money, that they are starting to go to their accountant, they are starting to realize that their taxes may be $25,000 a year, $30,000 a year, and it is capped at 10,000. So, some of them, this benefit that they are talking about, it is offset. And then we also have a state tax that is also capped. So, I think this tax bill stinks, quite frankly, in terms of New Jersey.

I think this tax bill was put together, they rushed it, they did not look at the impact that some of the states were going to have. And obviously, it impacted a lot of the blue states. And, quite frankly, I think we have to change it. I think it is going to hurt the real estate market in New Jersey a great deal after they file this year. Because people are starting to realize that they cannot write off what they have been writing off in the past.

And I know some of the Realtors are already making appointments in my office to say this. I have seen it slow down. I talked to some of the mayors in my district. They are very concerned about the tax bill and how it is going to impact their municipali-

ties. They are concerned because they are not going to be able to move some of this real estate that is going.

The district I represent, they called it the Gold Coast, you know, Hoboken, that whole area where there is a lot of development, a lot of good real estate has been developed.

So, you know, how do we correct this? Do you think that this tax bill aggravated the real estate market in some of these areas? Can anybody talk to that? In other words, has aggravated the downturn in home sales in certain regions of the country.

Mr. GALE. It certainly did in a couple of ways. The shift from personal exemptions to standard deduction greatly reduced the number of people that took the mortgage interest deduction. So, the number of people taking that deduction is falling from on the order of 26 percent to on the order of 11 percent. I am not sure those figures are exactly right, but it is that type of thing. And that, of course, will have ramifications for the value of real estate. The state and local tax deduction limitation, as you mentioned, will also have a similar effect in the high-tax states.

So, I mean, this is—I do not want in any way to minimize the problem. This is just an example of when you change a lot of things, a lot of things change. Some go up, some go down. And it seems real estate, charitable giving, health insurance and things like that are among the losers in this tax reform.

Mr. SIRES. Anybody else?

Ms. BRUCKNER. I think that it is definitely something we should measure and study after this first year of tax filing. Let's get a precise number on whether or not people benefitted with respect to the real estate provisions. I think it is something that certainly should be flagged for further study.

Mr. SIRES. Well, some people estimate that as many as 2 million people in New Jersey are not going to be able to write, you know, the real estate tax above the 10,000 that they were writing before. In my district, I have 10 minutes, but what was good about it is that people used to come to New Jersey because they realized that they could write that off because they made high wages in New York and now they can't.

Ms. BRUCKNER. I would be worried and interested in looking at the data on older people and older people who are still in their homes. I think——

Mr. SIRES. That, we have not gone into that but, obviously, they are impacted greatly.

Ms. BRUCKNER. And that is something, and there is not data on that, but that is something certainly to track.

Mr. SIRES. Thank you.

Chairman YARMUTH. The gentleman's time has expired. I now recognize Mr. Burchett of Tennessee for five minutes.

Mr. BURCHETT. Thank you, Mr. Chairman, ranking member. Everybody is wearing orange today. I want to thank you all so much for recognizing the University of Tennessee in our upcoming victory of Kentucky this weekend. I just want to make note of that.

Ms. Bruckner, I am not going to ask you any questions due to my collegiate history in accounting, so I am going to stay away from you, all right? As I stated many times, I liked first quarter

accounting so much, I took it twice and then I pursued a degree in education. So, thank you.

I guess, let's see, on the screen, Litton's Restaurant, that is owned by my buddy, Barry Litton. He, like my father, he served his country in the Marine Corps. He and his son, Eric, and Barry's sister, they just run a great restaurant. If you ever come to Knoxville and get near Fountain City, just ask somebody where Litton's is. It is wonderful, and it is a great restaurant.

And they have, as they have told me, they have actually seen an uptick since the tax break and they are very grateful for it. And it is a small business in Knoxville, just like 99 percent of the businesses in Tennessee are.

And I want to ask Ms. Pol, how do I say that name, Pol?

Ms. POL. Yes, you are right.

Mr. BURCHETT. Okay, great. In your opinion, you are the only small business owner on the panel, that seems to be correct. How has the new tax law helped you? And just give a specific. You know, everybody gives these numbers and statistics and, frankly, I get lost in all that. I deal with human interest and things like that. And thank you for being here, ma'am.

Ms. POL. Yeah, absolutely, thanks for having me. The biggest thing was being able to feel confident to give raises to our employees this past year. We have struggled with that the last few years, just due to health care costs. It is one of our major concerns. And so, we were able to give every one of our employees a raise.

And, you know, being able to get money back on the new tax law as far as the small business deduction, that has helped us invest. We invested in a warehouse, $2 million, and then also doing the 500,000 to the million dollars allowed us to invest in six new trucks that cost a million dollars. And so, we have not been able to do that for the last few years. But it gave us confidence going forward.

Plus, the spark of new businesses and new business that is coming our direction, because of the boost in the economy all the way around our area.

Mr. BURCHETT. Great. Thank you so much for being here, ma'am.

And is it Mr. Gale or is it Dr. Gale?

Mr. GALE. It's doctor.

Mr. BURCHETT. Doctor? All right, Doctor. You earned it, so I am going to call you that. In the energy sector, what type of taxes would you support? Would it be a carbon tax, a gasoline tax? And if so, what is your justification? And I am not going to jump you, I am not going to run for reelection on this.

Mr. GALE. I think the right approach is the carbon tax, with an exemption for low-income households or a rebate for low-income households. One of the numbers I came up with recently was that we could pay every coal worker $250,000 in severance pay and the total cost would be 1 percent of the 10-year revenue of a carbon tax. So, the impact on low-income communities is important. The impact on coal communities is important. But they are totally solvable situations.

The advantage of a carbon tax over a gasoline tax is that a carbon tax taxes many forms of carbon emissions, as gasoline is just one of them. So as broad a base as possible. A carbon tax, I think, is the right thing to do there. And it would not only help the envi-

ronment, it would help the fiscal situation and it would fix a big imperfection in the way the economy operates, which is right now people in businesses that emit carbon are not paying the full social cost of that carbon emission.

Mr. BURCHETT. Are you familiar with—this isn't in my notes and this always makes my folks nervous when I get off track, but I always get off track, so it doesn't matter. There is a new bill out, have you seen it, the one—and I had a group of people in Knoxville just last week come to—when you said that, it reminded me that they came to see me about that bill. It is a new type of idea that actually gives rebates to folks and are you familiar with that legislation?

Mr. GALE. There was a—I am not sure about the legislation. There was an economists' statement that was signed by a couple of dozen Nobel laureates and about 3,000 other people, including me, saying that we should do a carbon tax and we should rebate the money on a universal basis. That is my second choice.

I signed it because it would be so much better than what we are doing now. My first choice would be we use the revenues for a variety of purposes. But the main issue is to get the carbon tax in there.

Mr. BURCHETT. And I know I am out of time. But do you actually trust government with another pool of money, that they will actually do with it what they said they will do?

Mr. GALE. Compared to what, again? I feel like we have to tax carbon and then the question is what to do about it. The paying back, the people who want to pay it back mentioned precisely the issue that you mentioned, which is they do not trust government to use it, so they want to send the money back. I trust government more than that. I think we can reduce the debt, we could reform taxes, et cetera.

Mr. BURCHETT. Okay, thank you.

Chairman YARMUTH. The gentleman's time has expired. I now recognize Ms. Jackson Lee of Texas for five minutes.

Ms. JACKSON LEE. Chairman and ranking member, thank you very much. I have always indicated my appreciation for this committee because of the astuteness of all the witnesses. Let me acknowledge Ms. Pol, who has come a distance to share her story, and I think I have most of the facts of her story, and I thank her so very much for her testimony.

But I think it is important for me to set the groundwork very quickly to indicate sadly that this GOP tax scam is a failure. It raises the nation's debt by 1.9 trillion at a time when the economy was already strong. I lived through the 2009 debacle. In fact, I was a part of the discussion when the Secretary of the Treasury came late to the Congress to indicate, and that was of course some years before, that we were about to see a collapse that we had never seen before. That was Secretary Paulson.

And so, I have seen the trajectory and saw what we needed to do, an infusion of capital that many criticized. But the stimulus saved a lot.

So, we are now facing major, long-term budgetary challenges driven by our aging population. And rather than devoting resources to wise investments in our workers and small businesses, the GOP

tax scam further burdens workers, families, endangers Americans' retirement security and worsens our budgetary outlook.

Mr. Chairman, the verdict is in and none of the GOP tax scam promises have borne out. Our long-term economic growth trajectory is unchanged. There is no sign of an investment boom. Real wage growth for workers remain modest. And factories and jobs are more likely to go overseas. The federal deficit is soaring. We have the sequester. And as corporate tax receipts plummet into the government and the tax code is riddled with even more special interest tax breaks and loopholes.

As I quickly asked you a question in testimony before one of our committees dealing with pharmaceuticals, question was asked, have you taken the tax savings and invested back into research which would then help bring down the cost of prescription drugs? To my knowledge, let me qualify my recollection, that not one said that they had invested those tax benefits to any of us.

Let me immediately go to Ms. Bruckner in my first question. And that is, Professor Bruckner, what do typical women-owned firms look like in terms of their type, size, revenues? Did the GOP tax law address typical women business owners' needs in terms of accessing capital and growing their businesses, in particularly women of color?

May I just do this, if your memories are good, may I just go to—excuse my papers here—go to, so you can remember, to Ms. Huang. Some of my friends across the aisle have already been rehearsing their calls to pay for the tax cuts by making cuts to Social Security, Medicare, Medicaid. I just came from a Medicare for All presentation. Who will be hurt if we pay for the tax cut that way and what would this mean for Americans' retirement security or their access to good health care?

And to Dr. Gale, are we experiencing a Trump economic boom or simply a continuation of the Obama expansion began in 2009.

I have given you only a few seconds, but I know you are succinct, because I need other get all three of you.

Thank you for all your presence here.

Ms. BRUCKNER. I think that when we look at the business tax expenditures and how they were distributed among women business owners, there is a real question as to whether or not there is an equitable distribution, particularly when you measure it in terms of the revenue lost. For example, 199A cost $415 billion but more than 50 percent of that is going to go to firms that have a million or more of revenues but only 1.7 percent of women business owners, who are 40 percent of all U.S. businesses, actually have revenues of a million dollars or more. That is just one example that warrants the specific study of tax expenditures.

Congress needs to know if where you are investing you are getting a rate of return and women business owners tend to start businesses more.

Ms. JACKSON LEE. Thank you. Quickly, Ms. Huang.

Ms. HUANG. There is a big risk that low and moderate income Americans end up being worse off by this tax law. If the increase in deficits from those tax cuts primarily for the wealthy end up in underinvestments in basic infrastructure, child care, facing challenges like climate change and of aging population, and in fact we

have seen budget proposals from proponents of the tax law that would cut supports in housing and health care and in a variety of other programs that help Americans achieve shared prosperity.

Ms. JACKSON LEE. I thank you. Dr. Gale?

Mr. GALE. All right, I think there are five things that are affecting the economy positively right now. The first, sorry, the first is that we have been building on a long economic boom. The second is the tax cuts have definitely had a positive stimulus effect in the short run. Almost any tax cut that put money in people's pockets would do that. Third, the 2018 spending deal that Congress reached has helped boost the economy. Fourth, oil prices have gone up and the U.S. is now a net supplier of oil so that helps the economy, whereas it used to hurt the economy. And fifth, the Fed has indicated that it is going to ease off on interest rate hikes, which also helps the economy. So, the tax cut is part of that, but I would not give all credit for everything positive to the tax cut.

Ms. JACKSON LEE. And it is countered by the deficit that is growing.

Mr. GALE. That is a longer-term effect. And over time, the stimulative effects of the tax cut will wear out and the long-term effects of the deficit will get bigger and that is why CBO predicts that by the end of 10 years, there will be virtually no impact on the size of the economy.

Chairman YARMUTH. The gentlelady's time has expired.

Ms. JACKSON LEE. Thank you, Mr. Chairman.

Chairman YARMUTH. So, it is now down to the ranking member and me.

Mr. WOMACK. As it usually is.

Chairman YARMUTH. It is. The ranking member is recognized for 10 minutes.

Mr. WOMACK. I want to thank each of the witnesses that have been before us today. And thank you, Mr. Chairman, for having this hearing.

Some of my colleagues on the other side of the aisle and some of the witnesses have talked about how the Tax Cuts and Jobs Act has led to income inequality. Let's just review some facts. And if these are incorrect, please take issue with them.

Median household income is at an all-time high. More people than ever live in households earning $100,000 or more, fewer households earning less than 35,000. Share of income as it pertains to the top 5 percent of income earners has remained the same since 1995. And the share of income as it pertains to the top 20 percent of income earners has remained the same since 1995.

So I struggle with the claims that the Tax Cuts and Jobs Act has led to a bigger gap in income inequality. And my thesis going into my opening statement was about that Washington, D.C., the federal government, has a spending problem not a revenue problem. Revenues are up but spending is up on a much bigger percentage of GDP.

And then I want to go back to what was said earlier, and I think it is worth coming back to. And that is that, Dr. Gale, you said that you had created some jobs for some contractors. But in terms of let's just say risk, business risk, what risk have you taken? You have read a lot of literature but what risks have you taken that

give you some inside view, some more than just a theoretical view, but what risks have you taken, what jobs have you created that give you authority on the subject?

Mr. GALE. One of the biggest professional risks that I took was opting to pursue a Ph.D. That is a long process, it is not always a successful process.

Mr. WOMACK. Did that create any jobs?

Mr. GALE. You were asking me what risks I have taken. My point, if you will let me finish, is there is——

Mr. WOMACK. Since I haven't got a lot of time, let me reclaim my time. Have you created any jobs?

Mr. GALE. Depends what you mean by created jobs. When I was——

Mr. WOMACK. Have you had to negotiate a health care program? Have you turned the key in the door? Have you had to buy equipment and hire people?

Mr. GALE. When I was the head of the economic studies program at the Brookings Institution, from 2006 to 2009, the program tripled in size and we funded that increase.

Mr. WOMACK. And that was someone else's money, it wasn't yours?

Mr. GALE. No, it was not my money. I don't personally finance the Brookings Institution.

Mr. WOMACK. All right, Ms. Huang, a question for you. What——

Mr. GALE. We raised the jobs externally and hired people.

Mr. WOMACK. How many jobs have you created, Ms. Huang?

Ms. HUANG. So, I think the premise of the question that you are——

Mr. WOMACK. It is a real simple premise. How many jobs have you created?

Ms. HUANG. Well, I think it is not so simple to understand——

Mr. WOMACK. What health care programs have you negotiated——

Ms. HUANG.——that workers—the workers who take home a paycheck and work hard——

Mr. WOMACK. Let me finish my question, respectfully. All right?

Ms. HUANG.——for low wages and spend that money are also part of what keeps this economy vibrant.

Mr. WOMACK. Okay. My question is, you are an expert witness on the Tax Cuts and Jobs Act, sitting before the Budget Committee of the United States House of Representatives. And a member is asking how many jobs have you created that gives you more than just some kind of academic background on the impact of the Tax Cuts and Jobs Act? How many?

Ms. HUANG. I don't know. I don't know when I was——

Mr. WOMACK. Have you created any? Have you created any jobs?

Ms. HUANG. When I was a factory worker, working for minimum wage, I don't know what impact that had throughout the community.

Mr. WOMACK. Okay, the witness is not cooperating, Mr. Chairman.

Ms. HUANG. I don't know when I was advising startup businesses what impact that had throughout the economy.

Mr. WOMACK. Let's turn to Ms. Bruckner. Ms. Bruckner you did have some kind of a previous background in some kind of a job creation situation, did you now?

Ms. BRUCKNER. Yes.

Mr. WOMACK. How many jobs were created?

Ms. BRUCKNER. I am not a business owner yet.

Mr. WOMACK. Okay, so I think it is safe to say that, of the panelists here today, and we have four, that of the panelists here today, to critique the Tax Cuts and Jobs Act, to put under impeachment, if you will, the very premise that the Tax Cuts and Jobs Act is working, as evidenced by the fact that unemployment is low, wages are higher and we have gone through the whole litany of the benefits of the Tax Cuts and Jobs Act, that 75 percent, three out of the four witnesses here today, haven't created jobs, haven't negotiated a health care contract, haven't had to deal with signing the front of a check as well as the back of a check. These are people that spend most of their time in academia, through some kind of a bureaucratic, in some kind of a bureaucratic maze, reading a lot of numbers, a lot of literature, writing a lot of articles about it.

But where the rubber meets the road, the only witness that is standing or sitting before this committee today is Ms. Pol from Iowa, flyover country.

Ms. Pol, how many jobs have you created?

Ms. POL. Currently, we have 54 employees.

Mr. WOMACK. Fifty-four employees. And where did you start?

Ms. POL. We started with one, my father.

Mr. WOMACK. Okay, so and as my friend, Mr. Woodall characterized you, you are a kind of a serial entrepreneur. It dates back into years.

So, Ms. Pol, I would trust that somebody that has actually been in the business of creating jobs and opportunity for their people has kind of an inside baseball look at what Tax Cut and Jobs Act provisions have done for your business. So would you, just in a matter of a few seconds, kind of give me a highlight as to what it was able to do for you that you would not have been able to do otherwise?

Ms. POL. Sure. As I spoke before on, that we spent the million dollars. And that helped, to be able to, you know, deduct that immediately, expense it out immediately instead of depreciating it out, it really, really helped us tax wise this year. I am in the process of buying my brothers out so I have a huge debt load on myself. And when we spent that money, we also borrowed money. And also the same way with the warehouse. I am not a wealthy person, you know. Even though we have these companies, we give back to the community, we give back to our employees.

And so by doing this, we needed to do it. But it was scary to do in our position where we are financially with our company. And so having to be able to have these deductions and the help on that and to getting some cash flow back into our company kind of revitalized us.

Mr. WOMACK. Giving you hope?

Ms. POL. Yes.

Mr. WOMACK. For the future?

Ms. POL. Absolutely.

Mr. WOMACK. Are you still thinking expansion, thinking of hiring more people?

Ms. POL. Yes, yeah. I am scared of the future, for the fact that it is not permanent. That is what scares me going into the next generation.

Mr. WOMACK. But to be fair, I would also say that it is not just tax policy. There are a lot of other inputs rather than tax policy, cost of energy and, you know, competition for labor and a whole lot of other things. But I am going to take it that, in your response, you are basically saying that the Tax Cuts and Jobs Act has helped you, an individual business owner in small town Iowa actually help, help your cause, help your business?

Ms. POL. Yes, it has.

Mr. WOMACK. A question for Dr. Gale. CBO Director Keith Hall testified before this very committee on a question that I had raised about elevating the corporate income tax. Because there is a movement afoot or at least a theory that we need to—we went too far, we took it to 21, we cut it 14 points and we need to move it back up. My friend right here from the great Commonwealth of Kentucky thinks 28 is the right number.

Director Hall said that it would lead to the inverse of what we have seen in the passage of the TCJA, and that is we would see declining growth and employment.

Do you have concerns about what would happen if, in fact, the corporate rate went back the other direction?

Mr. GALE. I have no interest in disputing what Director Hall said. I would emphasize that the issues, the changes to the corporate tax should be not just to the rate but to the base. If we expanded the scope of expensing, we would encourage new investment and hence encourage new jobs. And by raising the rates, we would reduce the windfall gains that are currently accruing to people who made investments in the past.

So, I would encourage something that raised the rate and transformed the base. But I think Director Hall is right, if you just raise the rates, you would undo some of the positive effects.

Mr. WOMACK. All right, quickly, Ms. Huang, and I know I am going to be out of time here in a minute. If you follow your Twitter feed, it is obvious that you have an interest in a lot of things that involve spending a lot more money. So maybe the basis for your arguments about Tax Cuts and Jobs Act not working is the fact that allowing more people to keep more of their money prevents the government from having more of their money, which allows the government to provide more things. And you are big on a wealth tax, are you not?

Ms. HUANG. I think that there is a lot of room and a lot of different ways to raise progressive revenues to meet the fiscal challenges that face this country.

Mr. WOMACK. You like the wealth tax, don't you?

Ms. HUANG. I like a lot of different approaches.

Mr. WOMACK. What about the Green New Deal?

Ms. HUANG. I don't know the details.

Mr. WOMACK. What about free college?

Ms. HUANG. I don't know the details of that, either.

Mr. WOMACK. What do you think about policies about work requirements for people that are on the social safety net program that are not employed, that are single people without dependents and able bodied? What do you think about that policy?

Ms. HUANG. Many people who are beneficiaries of Medicaid and food stamps are, in fact, workers. And those social safety nets——

Mr. WOMACK. Those that are not?

Ms. HUANG.——are actually very important because they help people over time do well in their homes and in their communities and be able to work. So I think it is actually really counterproductive to require——

Mr. WOMACK. I am out of time.

Ms. HUANG.——paperwork tests that would increase the number of bureaucratic hoops that they would have to go through to get that basic assistance.

Mr. WOMACK. I appreciate the witnesses. Thank you.

Chairman YARMUTH. I thank the gentleman.

I now yield myself 10 minutes and begin by saying that the ranking member is truly a friend and I have great respect for him, as I do for all the members. And the strategy here from the other side has been very clear. It has been to try and discredit experts who have spent years doing research and analysis of very important topics and to hold up individual examples of business people for whom the tax cuts have been helpful. And we understand, obviously, that the tax cuts have helped some people.

My college classmate, Steve Schwarzman, who is the chairman and founder of the Blackstone Group, was helped substantially by the tax cuts. He made $700-plus million last year and I am sure he is very happy with the tax act of 2017.

I started several businesses. I unlocked the door, I negotiated health care contracts, I worried about who was making payroll. I was always the last one paid. My brothers and sister and my father all were entrepreneurs.

I don't think any of them, possibly my father, but I don't think any of the four of us siblings who have started businesses and run businesses would have ever said we are the definitive answer to the impact across the country of a certain policy of the federal government. I never would have been as presumptuous to say, because a policy had certain impact on me, that I know what the impact on the federal budget was. And that is, of course, what the purpose of this hearing is, is to determine what the impact of the tax cut has been and will be on the federal budget.

So, let's focus on that for a second. And there seems to be a substantial difference in a very important question in relation to what the impact on the budget is. Republicans say, and I am not disputing that they are wrong, that revenues have never been higher for the federal government as they have been since the tax cut was passed. We Democrats say, and some of you in your testimony have said, revenues have been hurt by the tax cut and will continue to be hurt by the tax cut.

How do you reconcile those two, assuming they are both true? And I actually do believe they are true.

Dr. Gale, would you like to reconcile that?

Mr. GALE. Yet again, it is a compared-to-what question. Revenues would be higher if we had not passed the tax cut. That seems like a very clear conclusion from everything CBO and JCT do. And I am sure when Director Hall testified on that, that that was an implication of his testimony.

But, you know, the economy grows over time. There are more people. So, there is more productivity. So, you know, there is a natural upward trend in the level of revenues. That trend was simply displaced somewhat by the tax cuts.

Chairman YARMUTH. Ms. Huang, do you want to answer?

Ms. HUANG. As a share of the economy, which is really what the nation can afford in terms of its resources, revenues as a share of the economy are at its lowest level in 50 years outside of a recession.

Chairman YARMUTH. And the fundamental conclusion or estimate of CBO that the tax cut specifically is going to be responsible for an additional $1.9 trillion worth of debt over 10 years, assuming the law stays as it is and the higher amount, if we extend the expiring tax cuts, that has not changed, right?

Ms. HUANG. Not that I am aware of. And in fact, the 1.9 trillion, there was a question earlier, the 1.5 was the initial estimate, the 1.9 is the re-estimate based on later data in terms of how much it will cost.

Chairman YARMUTH. Mr. Womack talked about how, and again I have no reason to dispute this, that income levels have not substantially changed in terms of percentages over the last decade or so. What about wealth? I did not hear him talk about how wealth has changed, the disparity in wealth over the last decade or so.

Mr. GALE. Both income and wealth have become more unequally distributed in gradual processes over the last 40 years. The sources of the widening distribution have changed over time, but the trends are evident. The wealth trends are even starker than the income trends in terms of how much has been concentrated in the top 0.1 percent, 1 percent, et cetera.

Chairman YARMUTH. Getting back again to a question of, not so much impact on the budget, although all of this has an impact on the budget, but we talked about the question of fairness early on. I believe Mr. Crenshaw was talking about fairness.

And one of the things that occurs to me is that we have a fundamental issue, philosophy, as to whether we tax rental income or productive workers' income differently or similarly. Does anybody want to address that? You know, I am looking at these enormous incomes that we are seeing and many of those people are in the top 0.1 percent, who derive such a huge benefit from this tax cut. And it seems to me that many of those incomes are derived from essentially rental, what is referred to as rental income. They are basically not doing anything on a daily basis, they are getting royalties, they are getting dividends and so forth.

Dr. Gale?

Mr. GALE. Thank you. Perhaps the primary with the Section 199A, the passthrough provisions, is that it taxes business income at a lower level than wage income. That gives people incentives to shift wage income to business income, which is an obvious form of tax shelter. It gives businesses incentives to either divide or com-

bine to take advantage of the odd limits in the bill. It is incredibly complex.

You know, these are concerns with the provision. There is no doubt that particular small businesses have gained from it, they got a tax cut. The question is, is it a well-designed tax policy? And by every principle we know of well-designed tax policy, the answer is, no.

Chairman YARMUTH. Is there any justification you can think of to maintain the carried interest tax rate, which President Trump claimed that he was going to do away with but, unfortunately, from my perspective, is still part of the law after the 2017 act?

Mr. GALE. I think it is pretty clear that carried interest should be taxed as labor income, not as capital gains. But in terms of taxing wealthy households and raising revenues, there is actually not much money in carried interest. There is much more money in wealth tax, taxing capital gains at death, undoing the 199 features and so on.

Chairman YARMUTH. One final question, and I am really struck, Ms. Bruckner, by the amount of small businesses, the number of small businesses generating, and probably these are all new small businesses, growing small businesses—young, is that the word?—small amounts of income, and the lack of capital that they are dealing with. Isn't one of the issues here, the fact that, very few businesses, big businesses, got the corporate tax rate? By the way, I am not necessarily saying 28 percent is the right number. I said, Obama was willing to go to 28 percent when the corporate tax rate was 35. I think we could afford some additional taxes, 28 may or may not be the right number.

But anyway, one of the things I have heard is there is so much cash in the economy right now, in corporations, they have so much liquidity that giving them more was not going to make them invest because if they had opportunities to invest in productive activities, additional ones, they would have had the money to do that. At the same time, we have this problem, we had so many young small businesses not being able to have access, and this tax cut did nothing to help them. Is that kind of a fair reading of where we are?

Ms. BRUCKNER. I think with respect to small businesses, the quickest and most efficient place that you can get any kind of equity infusion is from your profits. And one other way that you can do that is from lower taxes.

I don't think there is a question that most businesses got some sort of tax cut, right? The bill was designed that way. But when we are looking at questions of equity and fairness, are we looking at we need to request questions about did we create lower taxes for the businesses who needed it most versus for the businesses that might have been otherwise just as profitable?

And I think the question really is, with larger businesses, you are seeing lots of share buybacks, which is a way to increase shareholder value without having to actually pay dividends, which is a lower tax kind of strategy. Versus, you know, very, very small businesses that are desperate for access to capital, have trouble securing outside financing and might have needed a greater share of tax breaks. I am not saying that tax breaks are bad, I am saying we should be investing tax breaks where we think, and we should

study where they think that we are going to have the most bang for our buck. And we have not been doing that.

Chairman YARMUTH. Well, that concludes our hearing. I want to thank all of the panelists for all of your testimony. Thank you for traveling so far, Ms. Pol, we appreciate you being here.

Please be advised, members can submit written questions to be answered later in writing. Those questions and your answers will be made part of the formal hearing record. Any members who wish to submit questions for the record may do so within seven days.

I thank the ranking member once again. And, without objection, this hearing is adjourned.

[Whereupon, at 12:38 p.m., the Committee was adjourned.]

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A PRELIMINARY ASSESSMENT OF THE TAX CUTS AND JOBS ACT OF 2017

William Gale, Hilary Gelfond, Aaron Krupkin, Mark J. Mazur, and Eric Toder

The Tax Cuts and Jobs Act of 2017 was the largest tax overhaul since 1986. Our assessment — based on a variety of sources — suggests that the act will do the following: stimulate the economy in the near term but have small impacts on long-term growth; reduce federal revenues; make the distribution of after-tax income less equal; simplify taxes in some ways but create new complexity and compliance issues in others; and reduce health insurance coverage and charitable contributions. Its ultimate effects will depend on how other countries, the Federal Reserve Board, and future Congresses respond.

Keywords: Tax Cuts and Jobs Act, tax cuts, economic growth, distributional effects

JEL Codes: H2, H3, H6, H8

I. INTRODUCTION

On December 22, 2017, President Donald Trump signed into law the biggest tax overhaul since the Tax Reform Act of 1986. This paper summarizes the provisions of the law — commonly referred to as the Tax Cuts and Jobs Act (TCJA) — and provides a preliminary assessment of its effects, largely based on existing analysis.[1]

The new tax law makes substantial changes to the rates and bases of both the individual and corporate income taxes, most prominently cutting the maximum corporate income tax rate from 35 to 21 percent, redesigning international tax rules, and providing a deduction for pass-through income. Other major changes include the following: expensing

[1] This paper is a condensed version of Gale et al. (2018). For related work, see Chalk, Keen, and Perry (2018), Harris and Looney (2018), and Slemrod (forthcoming).

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of equipment investment; elimination of personal and dependent exemptions, the tax on people who do not obtain adequate health insurance coverage, and the corporate alternative minimum tax (AMT); and increases in the standard deduction, the estate tax exemption, and the individual AMT exemption. Almost all of the individual income tax and estate tax provisions expire after 2025, while most of the corporate income tax provisions are permanent.

As a large, deficit-financed tax cut, the TCJA will stimulate the economy in the near term, but most models indicate that the long-term impact on gross domestic product (GDP) will be small. The impact will be smaller on gross national product (GNP) than on GDP because the law will lead to net capital inflows from abroad to finance investment that will pay returns to foreign residents. The new law will reduce federal revenues by significant amounts, even after allowing for increased economic growth. It will make the distribution of after-tax income more unequal. If it is not financed with concurrent spending cuts or other tax increases, the TCJA will raise federal debt and impose fiscal burdens on future generations. When the TCJA is eventually financed with spending cuts or other tax increases, the combination will, under the most plausible scenarios, end up making most households worse off than if the TCJA had not been enacted. The new law simplifies taxes in some ways but creates new complexity and compliance issues in others. It will lead to higher health insurance premiums and reduce health insurance coverage. It will adversely affect many sectors, including healthcare and charitable organizations.

Section II discusses the main features of the new law. Sections III, IV, and V discuss the impact on the federal budget, economic growth, and income distribution. Section VI discusses the effect on complexity and compliance. Section VII considers effects on the states; on the healthcare, charitable giving, and housing sectors; and on the trade deficit. Section VIII discusses a number of uncertainties raised by the new law. Section IX concludes.

II. DESCRIPTION OF TCJA PROVISIONS

A. Individual Income and Estate Tax

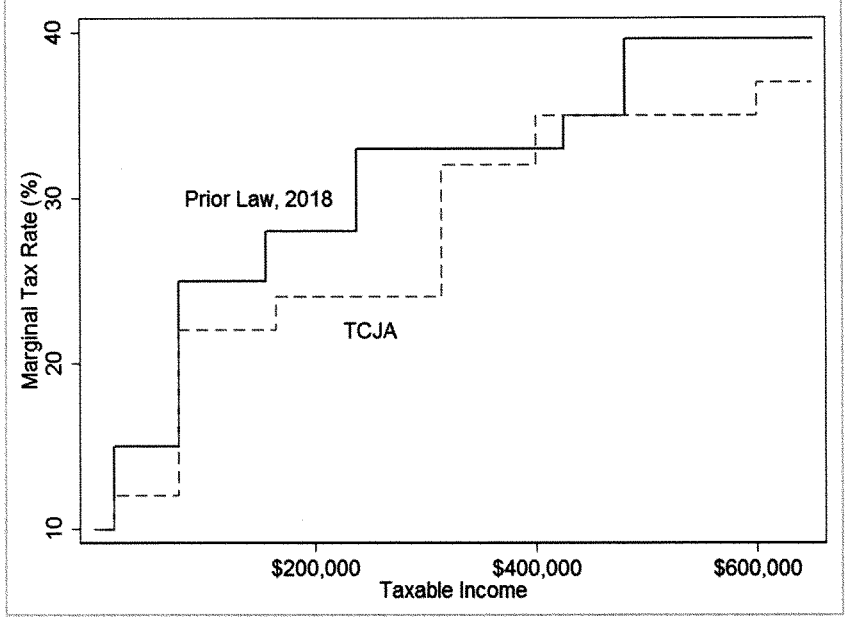
The TCJA reduces marginal statutory tax rates at almost all levels of taxable income and shifts the thresholds for several income tax brackets (Figure 1). The top marginal rate falls from 39.6 to 37 percent. The remaining rates are 10, 12, 22, 24, 32, and 35 percent.

The TCJA repeals personal and dependent exemptions. In place of these provisions, the TCJA increases the child tax credit in several ways, creates a new $500 tax credit for dependents not eligible for the child tax credit, and almost doubles the standard deduction (and indexes it for inflation), raising it from $13,000 to $24,000 for married couples filing jointly, $6,500 to $12,000 for single filers, and $9,500 to $18,000 for heads of households.

The TCJA limits the itemized deduction for all state and local taxes to $10,000, for both single and joint filers, and does not index that limit for inflation. For taxpayers

Figure 1

Marginal Tax Rate by Taxable Income



taking new mortgages, the TCJA limits deductibility to interest on the first $750,000 of loan principal on primary and secondary residences and eliminates the deductibility of interest for home equity debt. For 2017 and 2018, the TCJA allows a deduction for out-of-pocket medical expenses above 7.5 percent of adjusted gross income (AGI). After 2018, the prior law 10 percent of AGI threshold applies. The TCJA repeals the phasedown of the amount of allowable itemized deductions (Pease provision). Starting in 2019, the TCJA sets the Affordable Care Act's (ACA's) individual mandate penalty tax to zero.[2]

The TCJA retains the 0, 15, and 20 percent preferential tax rates on long-term capital gains and qualified dividends and the 3.8 percent net investment income tax (NIIT). Unlike prior law, the TCJA sets the tax brackets for capital gains and dividends based on taxable income rather than on the tax rate on ordinary income. The TCJA raises the exemption in the individual AMT to $109,400 for taxpayers filing joint returns ($70,300 for singles) and raises the phase-out threshold to $1,000,000 for joint filers ($500,000 for singles). The exemption and phase-out thresholds are indexed for inflation.

[2] Because the bill was passed via reconciliation procedures, under which only provisions that directly change revenues or outlays are permitted, the bill could not repeal the mandate, but instead set the penalty tax rate to zero (Committee for a Responsible Federal Budget, 2016).

The TCJA changes the measure used for inflation indexing, from the CPI-U to the chained CPI-U. The chained CPI-U more accurately measures changes in consumer welfare resulting from price changes than the traditional CPI-U.[3]

The TCJA introduces a new deduction for income from pass-through business entities (sole proprietorships, partnerships, limited liability companies, and S corporations). Joint filers with taxable income below $315,000 ($157,500 for singles) can receive a 20 percent deduction of their qualified business income (QBI), regardless of business type. At higher income levels, the size of the deduction for QBI depends on the taxpayer's income, business type, and the wages paid and property owned by the business. (For further details of how this provision works, see Gale and Krupkin, 2018.) In general, pass-through businesses, such as corporate income taxpayers, will be subject to the TCJA's changes to the business tax base — including both income and deduction items.

The TCJA doubles the estate tax exemption to $11.2 million for single filers and $22.4 million for couples and continues to index the exemption levels for inflation. Congress chose to allow most individual income tax and estate tax provisions to expire at or before the end of 2025 to meet the constraint on the 10-year revenue loss in the Congressional Budget Resolution and to comply with Senate budget rules that require no increase in the federal budget deficit after the 10th year. A few provisions do not sunset: the zeroing out of the ACA individual mandate penalty, the change in inflation indexing, and changes in the tax base for measuring business income (other than the pass-through deduction).

B. Corporate Income Tax

The TCJA reduces the top federal corporate income tax rate from 35 to 21 percent.[4] It eliminates the graduated corporate rate schedule and repeals the corporate AMT. The TCJA allows for 100 percent bonus depreciation (full expensing) for qualified property for five years, phasing out by 20 percentage points per year starting in 2023. The TCJA doubles the small business (section 179) expensing limit to $1,000,000 (with a $2,500,000 phase-out threshold) for qualified property. Several provisions of the TCJA broaden the tax base for measuring business income. These include limits on business deductions for net interest and net operating losses; elimination of the domestic production activities deduction; and, beginning in 2022, five-year amortization for research and experimentation expenditures instead of expensing.

The TCJA made sweeping changes to the treatment of foreign source income and international financial flows. Under prior law, the United States taxed the active income of multinational firms on a worldwide basis, less a credit for foreign income taxes paid, with U.S. taxes deferred until the income was distributed to the U.S. parent company.

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[3] As a result, the chained CPI-U rises more slowly than the traditional CPI-U, implying that individuals will end up in higher tax brackets and that indexed tax credits (like the EITC) will increase at slower rates than under the old indexing system.

[4] This change brings the U.S. rate more in line with most other OECD countries.

The TCJA created a modified territorial tax system. U.S. corporations continue to owe U.S. taxes on the profits they earn in the United States. However, the TCJA exempts from taxation the dividends that domestic corporations receive from foreign corporations in which they own at least a 10 percent stake. Under a pure territorial system, firms would have a strong incentive to shift real investment and reported income to low-tax jurisdictions overseas and to shift deductions into the United States. The TCJA contains several provisions to reduce the extent to which companies take those actions.

First, the TCJA imposes a 10.5 percent minimum tax without deferral on global intangible low-taxed income (GILTI) — defined as profits earned abroad that exceed 10 percent of the adjusted basis in tangible property. Companies can use 80 percent of their foreign tax credits, calculated on a worldwide basis, to offset this minimum tax, making the GILTI provision applicable for foreign tax rates less than 13.125 percent. The GILTI tax rate increases from 10.5 to 13.125 percent for tax years 2026 and later.

Second, the TCJA provides a deduction for foreign-derived intangible income (FDII) to encourage firms to hold intangible assets in their U.S. affiliates. FDII is income received from exporting products whose intangible assets are held in the United States. After application of this new deduction, FDII is taxed at a rate of 13.125 percent through 2025 and 16.406 percent thereafter instead of the 21 percent rate applied to other domestic profits.

Third, the TCJA imposes a new base erosion and anti-abuse tax (BEAT) at a 10.5 percent rate on the sum of the corporation's taxable income plus deductible payments (excluding costs of goods sold) made to foreign affiliates.[5] Corporations pay the larger of the regular tax or BEAT, which limits the ability of both foreign-resident and U.S.-resident multinationals to shift profits out of their U.S. affiliates.

To transition to the new system, the TCJA created a new "deemed repatriation" tax for previously accumulated and untaxed earnings of foreign subsidiaries of U.S. firms equal to 15.5 percent for cash and 8 percent for illiquid assets. Companies have eight years to pay the tax, with a back-loaded minimum payment schedule specified in the law. The Joint Committee on Taxation estimated that U.S. companies held more than $2.6 trillion in untaxed income in their foreign affiliates in 2015 (JCT, 2016).

C. Excise Tax Changes

The TCJA cuts taxes for most alcohol producers by reducing the excise tax on the first 60,000 barrels of beer produced by a seller from $7 to $3.50, reducing the excise tax on the first 100,000 proof gallons of distilled spirits from $13.50 to $2.70, and reducing the excise tax on the first 30,000 gallons of most wine from $0.17 to $0.07. These changes expire after 2019.

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[5] The tax is only levied on corporations with average annual gross receipts of at least $500 million and those that have made related party deductible payments exceeding 3 percent of the corporation's total deductions for that year. For this purpose, regular corporate tax liability is post–foreign tax credit but pre-research and experimentation tax credit.

III. FISCAL EFFECTS

The Congressional Budget Office (CBO, 2018a) estimates that the TCJA will increase the primary budget deficit by $1.8 trillion through 2028 and unified deficits (including interest payments) by $2.3 trillion. These estimates consider many behavioral responses, but they hold macroeconomic aggregates fixed. The CBO's dynamic revenue estimates (including macroeconomic feedback effects) predict that the law will raise primary deficits by $1.3 trillion through 2028 and unified deficits by $1.9 trillion. Including the macroeconomic effects, the debt-to-GDP ratio would rise by 6.2 percentage points by 2028 relative to a pre-TCJA baseline, assuming the temporary provisions in the TCJA expire as scheduled.

If lawmakers extended all of the temporary provisions in the legislation, the CBO estimates that primary deficits would rise by $2.6 trillion through 2028 and unified deficits would rise by $3.1 trillion. In 2028, the last year of the most recent budget projection, the debt-to-GDP ratio would be higher by 10.6 percentage points relative to a pre-TCJA baseline (excluding macroeconomic feedback) and the primary deficit would be higher by 1 percent of GDP.

IV. ECONOMIC EFFECTS

A. Background

In the short run, tax cuts can raise GDP by increasing aggregate demand. This raises the size of the economy relative to potential output but does not expand potential output (because potential GDP is based on aggregate labor supply, the capital stock, and the productivity of labor, none of which changes very much with respect to short-term changes in tax policy).[6] With the economy currently close to full employment, the impact on output of increased demand is much smaller than when there is a lot of slack in the economy. As the economy reaches its capacity, increased demand will lead to increased inflation, or the Federal Reserve will dampen demand by raising interest rates.

In the longer run, tax cuts can raise potential GDP by increasing incentives to work, save, and invest, thereby raising the productive capacity of the economy. These supply-side effects could lead to faster economic growth in the short and medium terms and a permanently higher level of output in the long run.

The Tax Policy Center (TPC) and CBO estimate that the effect on labor supply from the TCJA will be positive due to somewhat lower marginal income tax rates on labor income (CBO, 2018a; TPC, 2017). Increases in investment raise output gradually as the capital stock increases, as does capital per worker, and these changes raise labor productivity and, eventually, wages. Some provisions of the TCJA — such as reductions in tax rates on corporate and pass-through income and expensing of equipment

[6] Some economists argue that potential GDP depends on the path of actual GDP (DeLong and Summers, 2012).

investment — will raise after-tax investment returns. Other provisions — such as limits on uses of business losses, interest deductions, and the amortization of research and development expenses — can reduce after-tax returns. On balance, the new provisions in the TCJA are expected to reduce the pre-tax return companies must earn to make an investment profitable; thus, they should raise investment. However, the effects may differ dramatically across assets and industries, given the complexity and potential interactions of some of the new provisions (CBO, 2018a; TPC, 2017).

In the short run, lower corporate tax rates mainly subsidize the return to previously made investments. These gains benefit existing shareholders, including foreign shareholders, but do little to raise incentives to invest. This is particularly true when investments can be expensed — the treatment given to equipment purchases under the TCJA. With expensing, the effective tax rate is zero for marginal investments that are completely equity financed and negative for partially debt-financed investments. In fact, with expensing, a lower corporate tax rate *raises* the cost of debt-financed investments because it reduces the value of interest deductions.

Increases in investment can be financed with increased saving by the government or the private sector, or with higher net capital inflows from abroad. The TCJA will reduce public saving, i.e., increase the federal budget deficit. Domestic saving is relatively unresponsive to changes in its after-tax rate of return, and the TCJA does not provide new incentives to save.[7] As a result, most of the increase in investment will be financed by increased capital inflows from abroad. The CBO estimates that, by 2028, after the individual income tax cuts — and their associated positive effect on labor supply — expire and incremental output increases occur almost entirely from a higher capital stock, 71 percent of the increased income from higher U.S. GDP will flow to foreign residents (CBO, 2018a, 2018c).

This highlights a critical distinction between GDP, the output of the U.S. economy, and GNP, the income of Americans. GNP is equal to GDP *plus* the income that Americans earn from overseas investments *less* the income that foreigners earn from investment in the United States. GNP, therefore, is a better measure than GDP of the resources available to Americans. When domestic output is produced by capital owned by foreign investors, the capital income that accrues to investors is part of GDP but not part of GNP. As shown below, the TCJA's medium-term effect on GNP is considerably less than its impact on GDP.

The international provisions may also affect growth. The BEAT imposes taxes on inter-company transactions related to production inputs, rather than profits, and it can disrupt global supply chains. This can dampen economic activity. By taxing foreign returns in excess of 10 percent of foreign physical assets on a current basis, GILTI acts like a minimum tax on these sources of income. Accordingly, GILTI creates incentives that may more closely approximate a worldwide tax system than a territorial system. It also creates incentives, in certain cases, for firms to move tangible assets offshore because the first 10 percent of returns on investments in tangible assets in foreign countries is

[7] The corporate tax rate cut may reduce corporate pension contributions (Gaertner, Lynch, and Vernon, 2018), which would reduce private saving.

exempt from U.S. tax both when earned and when repatriated. This also could dampen U.S. economic activity by reducing domestic investment. Last, these provisions may interact in complicated ways that could raise effective tax rates for U.S. multinational firms (Desai, 2018; Sullivan 2018a, 2018b).

Finally, the deemed repatriation provisions — which allow firms to "bring back" funds previously accrued in foreign subsidiaries at a reduced tax rate — are likely to only have small effects on growth. Repatriation refers to the need to recognize the funds for U.S. tax purposes before making the resources available to the parent firm for domestic capital investment, dividend payments, or share repurchases. The cash that firms repatriate will probably not do much to spur growth or create jobs because much of the previously accumulated foreign profits are, in fact, already held in U.S. banks that could lend to participants in the U.S. economy, or held in domestic securities. Prior evidence on the effect repatriated earnings can have on economic activity suggests a limited domestic impact. After the 2004 temporary repatriation tax holiday, firms that repatriated funds often used these resources to buy back stock and pay dividends to shareholders and did not, on average, boost their domestic investment or increase domestic employment (Dharmapala, Foley, and Forbes, 2011; Gale and Harris, 2011; Looney, 2017c).

B. ESTIMATED EFFECTS

In the short term, many studies find that the TCJA will raise GDP in the United States, with most of the estimates ranging between 0.3 and 0.9 percent, on average, over the first three years (Table 1).[8] In the next several years, the general pattern is that GDP will be larger than it would have been otherwise, but the effect then declines as expensing is phased out, the individual income tax cuts expire, and selected business tax increases take effect. Most estimates suggest that the economy will be larger by between 0.3 and 0.7 percent over the next decade. There is expected to be some positive effect on output from increases in labor supply and investment, but these gains are partially offset by the crowding out of investment caused by higher interest rates associated with larger federal budget deficits. By 2027, most estimates show the TCJA increases GDP by between 0.1 and 1.1 percent.

Importantly, the CBO projects that, while GDP will be 0.5 percent higher in 2028 than it otherwise would have been, GNP will only be 0.1 percent higher (CBO, 2018a). This difference reflects the important role of capital inflows and the resulting payments to foreign investors for the capital provided, discussed above. Additionally, GDP will increase more than GNP because some income currently reported as offshore earnings will now be reported as domestic profits due to the changed tax incentives for allocating profits from intangible assets.[9]

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[8] Barro and Furman (2018), CBO (2018a), International Monetary Fund (2018), Mertens (2018), Zandi (2017), University of Pennsylvania (2017), Tax Foundation Staff (2017), and Page et al. (2017).

[9] Defining net national product (NNP) as GNP less depreciation of the capital stock and noting that the TCJA will raise investment over the decade raises the possibility that the change in NNP may well be zero or negative relative to pre-TCJA law (Page and Gale, 2018).

Table 1
TCJA Growth Effects

	Effect on Size of GDP (%)[1]			10-Year Dynamic Revenue Feedback (%)
	2018–2020	2018–2027	2027	
TCJA, As Written				
Barro and Furman (with crowd out)	NA	NA	0.2	16.7[2]
Congressional Budget Office	0.6	0.7	0.6	31.0[3]
International Monetary Fund	0.8	0.6	−0.1	NA
Mertens	0.3–2.4	NA	NA	NA
Moody's	0.4	0.3	0.4	NA
Penn–Wharton Budget Model (low return)	NA	NA	0.6	7.7
Penn–Wharton Budget Model (high return)	NA	NA	1.1	19.1
Tax Foundation	0.9	2.1	2.9	69.5
TPC	0.7	0.5	0.0	12.8
TCJA, Extended				
Barro and Furman (with crowd out)	NA	NA	1.0	20.5[2]

[1] All figures are approximations.
[2] Dynamic revenue effects do not incorporate crowd out.
[3] Primary deficit effect.
Sources: Barro and Furman (2018); CBO (2018a); International Monetary Fund (2018); Mertens (2018); Zandi (2017); University of Pennsylvania (2017); Tax Foundation Staff (2017); Page et al. (2017).

All the estimates above analyze the tax cut as it was legislated, with temporary provisions expiring as scheduled. If, instead, the temporary provisions are extended, and the scheduled increases in some corporate provisions are not allowed to take effect, Barro and Furman (2018) estimate that the economy would be 1.0 percent larger in 2027 than it would have been relative to a baseline that assumes pre-TCJA law holds, meaning that expiring provisions in prior law would have been allowed to expire as scheduled (including crowd out effects of government debt). That baseline seems most appropriate for the estimates that examine the TCJA as written because it compares the actual new law with the actual old law. However, for analysis that assumes the temporary TCJA provisions are made permanent — presumably because policymakers routinely extend temporary provisions — the more appropriate baseline would be to consider pre-TCJA law with the temporary provisions that existed then also extended. Barro and Furman (2018) suggest that, under this alternative baseline, GDP in the 10th year would be about 0.3 percent larger than under a baseline using pre-TCJA law without the temporary provisions extended. Thus, assuming policymakers would extend temporary provisions under both pre-TCJA law and the TCJA, Barro and Furman's estimates imply that the TCJA would raise 2027 GDP by 0.7 percent (1.0–0.3 percent) relative to what it would have been without the TCJA. So, both in the context of the TCJA as written and under the assumption that temporary provisions are extended in a revenue-reducing manner, Barro and Furman estimate the effects on the size of the overall U.S. economy to be relatively small.

C. Macroeconomic Feedback

The increases in GDP are expected to offset, to some degree, the revenue losses of the TCJA, as estimated under conventional scoring, but do not come close to making the tax cuts self-financing (Table 1). For example, the CBO estimates the dynamic (or macroeconomic) effects reduce the primary 10-year deficit figure by 31 percent. The TPC and the Penn–Wharton Budget Model find offsets between 7 and 19 percent due to these macroeconomic feedback effects. The Tax Foundation is an outlier, projecting an offset of almost 70 percent of the revenue cost due to increased economic growth.

V. DISTRIBUTIONAL EFFECTS

A. Standard Distributional Effects without Financing

The TPC estimates that the TCJA initially will cut taxes for most households, reducing household taxes, on average, by $1,610 in 2018 — a 2.2 percent increase in after-tax income (Table 2). After-tax income is estimated to increase by a greater percentage for high-income households than for low-income households — 0.4 percent for households in the lowest quintile, compared with 2.9 percent for those in the top quintile, more than 4 percent for those in the 95th–99th percentile, and 3.4 percent for taxpayers in the

Table 2

Distribution of Federal Tax Change by Expanded Cash Income Percentile, 2018[1]
Conference Agreement for H.R. 1, the TCJA
Baseline: Current Law
Summary Table

Expanded Cash Income Percentile[2,3]	Tax Units		Percent Change in After-Tax Income[4]	Share of Total Federal Tax Change	Average Federal Tax Change ($)	Average Federal Tax Rate[5]	
	Number (Thousands)	Percent of Total				Change (% Points)	Under the Proposal
Lowest quintile	48,780	27.7	0.4	1.0	–60	–0.4	3.7
Second quintile	38,760	22.0	1.2	5.2	–380	–1.1	7.6
Middle quintile	34,290	19.5	1.6	11.2	–930	–1.4	12.4
Fourth quintile	28,870	16.4	1.9	18.4	–1,810	–1.6	15.8
Top quintile	24,300	13.8	2.9	65.3	–7,640	–2.2	23.3
All	176,100	100	2.2	100	–1,610	–1.8	18.1
Addendum							
80–90	12,490	7.1	2.0	13.1	–2,970	–1.6	18.5
90–95	6,020	3.4	2.2	9.6	–4,550	–1.8	20.2
95–99	4,650	2.6	4.1	22.1	–13,480	–3.1	22.2
Top 1%	1,140	0.7	3.4	20.5	–51,140	–2.3	30.3
Top 0.1%	120	0.1	2.7	7.9	–193,380	–1.8	31.6

Notes: 5.2 million AMT taxpayers are in the baseline; 0.2 million are under the TCJA.

[1]Calendar year. Baseline is current law. Excludes effects of reduction in ACA Individual Shared Responsibility Payment to zero. http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm

[2]Includes both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative AGI are excluded from their respective income class but are included in the totals. For a description of expanded cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm

[3]The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are as follows (in 2017 dollars): 20%, $25,000; 40%, $48,600; 60%, $86,100; 80%, $149,400; 90%, $216,800; 95%, $307,900; 99%, $732,800; and 99.9%, $3,439,900.

[4]After-tax income is expanded cash income less individual income tax net of refundable credits, corporate income tax, payroll taxes (Social Security and Medicare), estate tax, and excise taxes.

[5]Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, the estate tax, and excise taxes) as a percentage of average expanded cash income.

Source: Urban-Brookings TPC Microsimulation Model (version 0217-1).

top 1 percent.[10] Overall, the TPC estimates 80 percent of taxpayers will receive a tax cut averaging about $2,100 in 2018 due to the major provisions in the TCJA, while about 5 percent will face an average tax increase of around $2,800, and 15 percent will experience no significant tax change.

The distributional effects in 2025 are similar to those in 2018. By 2027, however, the estimated distributional effects change substantially because of the expiration of almost all the individual income tax and the estate tax provisions at the end of 2025. On average, taxes in 2027 are expected to be little changed for taxpayers in the bottom 95 percent of the income distribution compared to pre-TCJA law (TPC Staff, 2017). In 2027, households in the top 5 percent of the income distribution are expected to receive virtually all of the net tax cuts, an average of $4,900 per household.

B. Distributional Effects with Financing

The standard distributional analyses shown above ignore the fact that tax cuts eventually have to be financed with higher taxes or lower spending. In this section, we explore the distributional effects of the TCJA using 2018 tax parameters and assume that one of three methods finances the tax cut: equal-dollar burden on each tax unit (per capita financing, or lump sum taxes), equal-share-of-income burden on each tax unit (proportional-to-income financing), and equal-share-of-pre-credit-income-tax liability burden on each tax unit (proportional-to-income-tax financing). The most regressive of the three options, per capita financing, is the method assumed in major macroeconomic analyses of the legislation (e.g., Barro and Furman, 2018). Arguably, this approach is the one of the three that most closely resembles recent Administration and Congressional budget proposals to cut entitlement spending (Office of Management and Budget, 2018; Stein, 2017; Werner, 2018).

Table 3 shows that with per capita financing, the combined effect of financing and the major provisions of the tax overhaul would raise taxes or fees for 74 percent of households (compared to less than 5 percent without financing), including for 100 percent of households in the bottom quintile. Almost 80 percent of households in the middle quintile would face tax increases.

If the TCJA were financed by proportional-to-income-tax increases or spending cuts, the combined effect of financing and the major provisions of the TCJA would raise taxes for 68 percent of households, including 91 percent of households in the bottom quintile and more than half of households in the middle quintile.

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[10] Taxpayers in the 95th–99th percentiles would gain more as a share of their incomes than taxpayers in the top 1 percent because they benefit the most from the cutback in the individual alternative minimum tax, and because taxpayers in the top 1 percent are affected more by the restrictions on state and local tax deductions and the loss limitation provisions, which increase tax liability. The distributional effects of the individual income tax provisions in 2018 are similar to those of the TCJA as a whole. The JCT (2018) estimates that the distribution of the pass-through provisions in the TCJA are even more regressive, with 44 percent of the benefit going to households earning more than $1,000,000 per year. Note that JCT estimates are not directly comparable to TPC estimates due to differing measures of income used to group taxpayers.

Table 3

TCJA with and without Financing
Distribution of Federal Tax Change by Expanded Cash Income Percentile, 2018[1]
Baseline: Current Law
Summary Table

	Without Financing			Equal Per Capita Financing			Proportional-to-Income Financing			Proportional-to-Income-Tax Financing		
Expanded Cash Income Percentile[2,3]	Percent with Tax Increase[4]	Percent with Tax Increase >1% of Income	Percent Change in After-Tax Income[5]	Percent with Tax Increase[4]	Percent with Tax Increase >1% of Income	Percent Change in After-Tax Income[5]	Percent with Tax Increase[4]	Percent with Tax Increase >1% of Income	Percent Change in After-Tax Income[5]	Percent with Tax Increase[4]	Percent with Tax Increase >1% of Income	Percent Change in After-Tax Income[5]
Lowest quintile	1.2	1.0	0.4	100.0	100.0	–11.1	90.8	79.7	–1.4	3.3	1.1	0.3
Second quintile	4.6	2.7	1.2	98.3	95.2	–3.7	77.9	45.6	–0.8	7.8	3.8	0.7
Middle quintile	7.3	3.4	1.6	79.8	54.1	–1.2	56.3	28.8	–0.4	16.8	8.0	0.6
Fourth quintile	7.3	3.3	1.9	38.1	15.6	0.2	50.3	21.8	–0.2	29.6	12.5	0.4
Top quintile	6.2	2.3	2.9	17.7	5.8	2.3	45.2	22.2	0.6	45.4	23.0	–0.5
All	4.8	2.4	2.2	74.2	63.1	0.0	68.1	44.6	0.0	17.0	7.9	0.0

Table 3 (Continued) TCJA with and without Financing
Distribution of Federal Tax Change by Expanded Cash Income Percentile, 2018[1]
Baseline: Current Law
Summary Table

	Without Financing			Equal Per Capita Financing			Proportional-to-Income Financing			Proportional-to-Income-Tax Financing		
Expanded Cash Income Percentile[2,3]	Percent with Tax Increase[4]	Percent with Tax Increase >1% of Income	Percent Change in After-Tax Income[5]	Percent with Tax Increase[4]	Percent with Tax Increase >1% of Income	Percent Change in After-Tax Income[5]	Percent with Tax Increase[4]	Percent with Tax Increase >1% of Income	Percent Change in After-Tax Income[5]	Percent with Tax Increase[4]	Percent with Tax Increase >1% of Income	Percent Change in After-Tax Income[5]
Addendum												
80–90	7.6	2.9	2.0	23.1	8.2	0.9	50.2	24.3	–0.2	43.9	20.0	0.1
90–95	5.5	1.4	2.2	16.7	3.9	1.5	54.1	26.5	0.0	55.0	27.5	–0.1
95–99	2.7	1.3	4.1	6.0	1.8	3.6	21.3	10.4	1.8	30.3	15.3	0.9
Top 1%	9.3	5.0	3.4	10.7	5.4	3.3	40.3	25.5	0.8	72.0	63.3	–2.6
Top 0.1%	16.2	9.7	2.7	16.8	9.9	2.7	46.7	34.7	0.1	81.2	73.1	–3.5

Notes: 5.2 million AMT taxpayers in the baseline; 0.2 million in the proposal. Percent with changes refers to tax units.

[1] Calendar year. Excludes effects of reduction in ACA Individual Shared Responsibility Payment to zero. The Conference Agreement proposals' financing cost would be distributed equally per tax unit. http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm

[2] Includes both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative AGI are excluded from their respective income class but are included in the totals. For a description of expanded cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm

[3] The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are as follows (in 2017 dollars): 20%, $25,000; 40%, $48,600; 60%, $86,100; 80%, $149,400; 90%, $216,800; 95%, $307,900; 99%, $732,800; and 99.9%, $3,439,900.

[4] Includes tax units with a change in federal tax burden of $10 or more in absolute value. Due to data limitations, excludes repeal of exclusion for employer-provided qualified moving expense reimbursements, repeal of deduction for moving expenses (other Armed Forces members), retirement plan and casualty loss relief for disaster areas, repeal of deduction for alimony payments and corresponding inclusion in income, simplified accounting for small business, modification treatment of S corporation conversions into C corporations; limitation and repeal of deduction by employers of expenses for certain fringe benefits, modification of limitation on excessive employee remuneration, tax gain on the sale of partnership interest on look-thru basis, craft beverage tax reform, and individual income tax portion of certain business provisions.

[5] After-tax income is expanded cash income less individual income tax net of refundable credits, corporate income tax, payroll taxes, estate tax, and excise taxes. Source: Urban-Brookings TPC Microsimulation Model (version 0217-1).

If the TCJA were financed by tax increases that were proportional to income tax liability, the results would be much more progressive because this approach builds on the highly progressive individual income tax. The combined effect of proportional-to-income-tax financing and the TCJA would raise taxes for 17 percent of households, with larger increases, on average, for higher-income households. Only 3 percent of households in the bottom quintile would face a tax increase under this financing mechanism compared to 72 percent of those in the top 1 percent of the income distribution.

C. Distribution with Financing and Growth

Incorporating optimistic estimates for faster economic growth does not change the distributional results very much. To illustrate this, in Table 3, we examine the share of households whose net tax burden in 2018 after the tax cuts and financing would increase by more than 1 percent of pre-TCJA baseline after-tax income. This approximates the share of tax units whose after-tax income would drop even after accounting for an economy that was 1 percent larger due to the TCJA.[11] Under equal per capita financing, 63 percent of households would experience a net tax increase greater than 1 percent of pre-TCJA baseline after-tax income, including every household in the bottom quintile and 54 percent of households in the middle quintile. Under proportional-to-income financing, 45 percent of households would experience a net tax increase greater than 1 percent of pre-TCJA baseline after-tax income, including 80 percent of households in the bottom quintile and 29 percent of households in the middle quintile.

Under proportional-to-income-tax financing, only 8 percent of households would experience a net tax increase greater than 1 percent of pre-TCJA baseline after-tax income and these tax increases would be heavily concentrated among high-income households.

D. Horizontal Equity

Traditional tax policy principles call for the tax system to promote horizontal equity or to provide roughly similar tax treatment for taxpayers in similar circumstances. This is often interpreted as taxpayers with equal income facing equal tax liabilities. The TCJA largely dispenses with this notion by introducing new distinctions for various types of income-producing activities.[12] For example, income for a wage earner is taxed differently than income for an owner of a pass-through business. Additionally, different types of pass-through businesses are taxed differently (e.g., accountants and lawyers are more limited in their deduction for pass-through income than architects and engineers). In all these ways, the TCJA makes distinctions that undermine the policy

[11] This growth assumption is generous since several studies estimate the growth effect to be less than 1 percent of GDP (Table 1). Moreover, as discussed above, the resulting increase in national income would be smaller than the increase in GDP.

[12] Toder (2018).

principle of horizontal equity (though there may be efficiency or other reasons for these distinctions).[13]

VI. COMPLEXITY AND COMPLIANCE

The TCJA will simplify taxes in three main areas. First, the TPC (2018) estimates that the number of people who itemize will fall by more than half in 2018, from 26.4 percent under prior law to about 11 percent under the TCJA. This will reduce recordkeeping for millions of households. Second, the TPC estimates that the number of taxpayers subject to the individual AMT (a particularly complex provision) will fall from 5.2 million in 2018 to about 200,000 because of the increase in the AMT exemption amount, the income threshold at which the exemption starts phasing out, and the elimination or curtailment of the two main provisions that caused most taxpayers to be on the AMT: the state and local tax deduction and personal exemptions (TPC, 2018). Third, the expansion of expensing for equipment purchases will simplify recordkeeping for many individuals who report business income on their tax returns and for many businesses filing corporate and partnership tax returns. Simplified accounting methods for smaller businesses (such as increased use of cash accounting) will also reduce compliance costs.

Despite those gains, it seems likely that the TCJA will end up making taxes more complicated on net for many taxpayers. The main sources of additional complexity are (1) the new distinctions that the TCJA creates between tax rates on wage and salary earnings and pass-through business income of individual taxpayers, (2) the distinctions between profits of C corporations and pass-through businesses, and (3) the new international taxation provisions (Avi-Yonah et al., 2017; Looney, 2017a; Toder, 2018). In addition, the hasty manner in which the bill was enacted left many ambiguous provisions and a substantial number of glitches in the law. Some of these issues may be addressed in subsequent interpretive guidance, but that is a slow process. Finally, almost all the individual income tax provisions and some of the corporate income tax provisions are scheduled to expire during the next decade. These factors will create complexity and uncertainty, as taxpayers aim to plan around the ambiguities in the law and assess the likelihood that provisions will be extended beyond their scheduled expiration dates. This added complexity will provide opportunities for aggressive taxpayers to be non-compliant and will make it more difficult for taxpayers trying to be compliant to navigate the rules.

VII. SECTORAL EFFECTS

A. States and Infrastructure Spending

The TCJA contains provisions that affect state governments and may make it more difficult to sustain political support for current or increased levels of state

[13] Supplementing these qualitative observations with quantitative estimates of the magnitudes would be a valuable area for future work.

spending (Feldstein and Metcalf, 1987). The limit on the itemized deduction for state and local taxes by itself is quite progressive: 96 percent of the higher federal income taxes are expected to be paid by taxpayers in the top 20 percent of the income distribution and 57 percent by taxpayers in the top 1 percent (Burman and Sammartino, 2018). However, to the extent it reduces political support for state and local spending (by increasing the after-tax cost for some taxpayers), the cap on the deduction could prove to be less progressive, as the majority of such spending goes to items such as education, health, and income support that mainly help low- and moderate-income households (Leachman and Lav, 2017). The limit on deducting state and local taxes may also reduce public support for more progressive state income taxes.[14]

The tax overhaul will also increase the cost to states of issuing tax-exempt municipal bonds because the reduction in corporate and individual tax rates under the TCJA will increase the interest rates borrowers require on municipal bonds to keep their returns competitive with similar risk taxable bonds (Bergstresser, 2017). This will increase the cost to states of debt-financing infrastructure at the same time that political support for taxes that fund infrastructure may be weakened.

B. Healthcare

While not the main focus of the TCJA, the tax overhaul is expected to have some predictable and largely negative effects on health insurance coverage. One part of the TCJA undercuts the "individual mandate" in the ACA by eliminating the penalty on individuals for not having adequate health insurance. The CBO estimates that this change will reduce the number of people with health insurance by about 8–9 million by 2027 since it directly reduces the number of people who choose to purchase insurance and raises premiums for individual insurance coverage.[15]

The TCJA's cuts to alcohol excise taxes, if passed through to consumers via lower prices, will raise alcohol consumption and could thereby raise alcohol-related deaths, crime, domestic violence, alcohol-related injuries, as well as costs to law enforcement officials and health providers.[16]

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[14] Some high-tax states are considering ways to permit their residents to circumvent the $10,000 annual limit on the itemized deduction for state and local taxes. Two possible approaches are (1) allowing certain charitable contributions to be credited against income taxes and (2) converting income taxes to employer-paid payroll taxes. It is not clear if these or other approaches are practical to implement or if they would stand up to legal challenge.

[15] In 2017, the CBO estimated that the elimination of the mandate would reduce the number of insured individuals by 13 million by 2027 (CBO, 2017). Using an updated model, the CBO (2018b, p. 20) reports that "the projections explained in this report incorporate revised methods for estimating the effects of eliminating the penalty. Using those updated methods, CBO and JCT estimate the reduction in health insurance coverage is about one-third smaller than the agencies previously estimated [i.e., one-third smaller than 13 million]."

[16] One estimate suggests that the legislation could cause around 1,550 alcohol-related deaths per year, including between 280 and 660 additional motor vehicle deaths (Looney, 2017b).

C. Charitable Sector

The increase in the standard deduction and limits on itemized deductions will significantly decrease the number of taxpayers who itemize and thus reduce the number of taxpayers who deduct amounts given to charity. The number of households who claim a deduction for charitable contributions is projected to fall from 37 million to 16 million in 2018, or from 21 percent of tax units to 9 percent (TPC, 2018). The reduction in individual marginal income tax rates and the increase in the estate tax exemption also diminish incentives for charitable giving. Those who continue to itemize are likely to be those with the highest incomes, who are also likely to be larger donors to charities. Thus, charities may lose many meaningful donations from millions of moderate-income households but experience a less substantial change in aggregate donations. The TPC estimates that the TCJA will reduce charitable giving by about 5 percent.[17] Additionally, since the estate tax directly reduces the price of charitable bequests compared to transfers to heirs, the temporary increase in the estate tax exemption in the TCJA may also reduce charitable giving by upper-income households (Bakija and Gale, 2003).

D. Housing

As noted above, the increase in the standard deduction will reduce the number of people who could benefit from itemized deductions related to homeownership. For some homeowners who previously itemized deductions, the scaled-back deductions for interest on new mortgages and on property taxes will make housing expenses costlier. The number of people who claim the mortgage interest deduction is expected to fall from 36.9 million (21 percent of households) to 16 million (9 percent) under the TCJA (TPC, 2018).[18] The changes may slow the growth in home prices, with the biggest effects for higher-priced homes and higher-income areas, but they are unlikely to significantly affect homeownership rates (Bartlett, 2013; Zandi, 2017; Gale, Gruber, and Stephens-Davidowitz, 2007; Gruber, Jensen, and Kleven, 2017; Kolomatsky, 2017).

E. Trade Deficits

In a standard macroeconomic analysis, the TCJA will increase the U.S. trade deficit. By increasing the federal budget deficit and encouraging U.S.- and foreign-owned business to invest more in the United States, the act will cause an inflow of funds to the United States. This, in turn, will cause the current account deficit to rise. As a

[17] Gleckman (2018). See also Indiana University Lilly Family School of Philanthropy (2017), which predicts a 4.5 percent decline, and Brill and Choe (2018), who predict a decline of 4.0 percent. The tax overhaul may also change the composition of donations since wealthier individuals tend to give to organizations such as museums and universities, while smaller donations by middle-income individuals tend to go more to social service and religious organizations (Frankel, 2017).

[18] The estimates are coincidentally similar for the mortgage interest and the charitable contribution deductions.

mathematical identity, if more money flows into U.S. capital markets from overseas, it has to be balanced by increased U.S. net purchases (imports minus exports) of current goods and services from overseas. Thus, the trade deficit is expected to increase in the wake of the TCJA. However, the TCJA may reduce one component of the measured trade deficit that makes the current trade deficit look larger than it really is. When U.S. firms hold intangible assets (patents, trademarks, etc.) in affiliates in low-tax foreign countries and pay royalties for use in production, the royalty payments to the foreign affiliate are treated in the national accounts as imports — as if the U.S. parent is purchasing services from the foreign affiliate. Thus, the mispricing of assets shifted between components of a U.S. multinational firm (incorrect "transfer prices") distorts the measurement of the trade deficit in government statistics. To the extent that they reduce incentives for U.S. multinationals to shift income earned by intangible assets to low-tax countries, the TCJA's international provisions, such as GILTI and FDII, will reduce the measured trade deficit, even if there is no change in where products are developed, produced, or consumed.

VIII. UNCERTAINTY

The future is always uncertain, but it seems particularly so with respect to many aspects of the TCJA. One set of issues concerns the effects of actual provisions of the new law: the impact of the new low corporate income tax rate on capital flows and investment, the extent to which corporate tax cuts lead to higher wages, whether the pass-through rules will prove administrable, and how multinational firms will respond to provisions such as BEAT and GILTI.

Another set of uncertainties is how other policymakers will respond: Will the Federal Reserve Board raise short-term interest rates in response to a tax cut that took effect at a time of full employment? How will states respond to the new limits on deductions for state and local taxes? Will other nations cut corporate taxes or adopt other tax incentives in response to the TCJA? Will U.S. trading partners challenge some new provisions as inappropriate trade subsidies or barriers via the World Trade Organization (WTO)? BEAT, for example, might be perceived as a selective import tariff and FDII as a selective export subsidy, in violation of WTO rules.

Other uncertainties center on the future of the legislation itself. Will Congress enact a technical corrections bill or a corrective reform package? The implementation of the TCJA may reveal administrative and enforcement flaws — such as in the pass-through rules or international provisions — that require structural reform. A similar episode occurred after the 1981 tax cut created enormous tax shelters and led to tax law changes in both 1982 and 1984, and, ultimately, the Tax Reform Act of 1986.

Will Congress extend the temporary provisions in the TCJA? As with the Bush tax cuts in 2001 and 2003, the plethora of temporary provisions in the TCJA virtually guarantees that lawmakers will have to revisit tax policy in the near future.

Will the TCJA change the politics of tax reform and the support for many long-standing provisions? The sharp decline in the number of filers who itemize their deductions could

reduce political support for itemized deductions and lead to further restrictions on such items (Graetz, 2011; Taylor, 2018).

IX. CONCLUSION

The TCJA's most fundamental and novel changes relate to domestic and international corporate tax rules and the tax treatment of pass-through business income. By reducing revenues and introducing structural changes, the TCJA seems more like the Economic Recovery and Tax Act of 1981 than the Tax Reform Act of 1986. The new law contains many ambiguities, phases out many provisions over time, and leaves U.S. revenues significantly below what is needed to address long-term fiscal shortfalls. All these aspects invite reconsideration over the next several years of the tax policy choices made in the TCJA.

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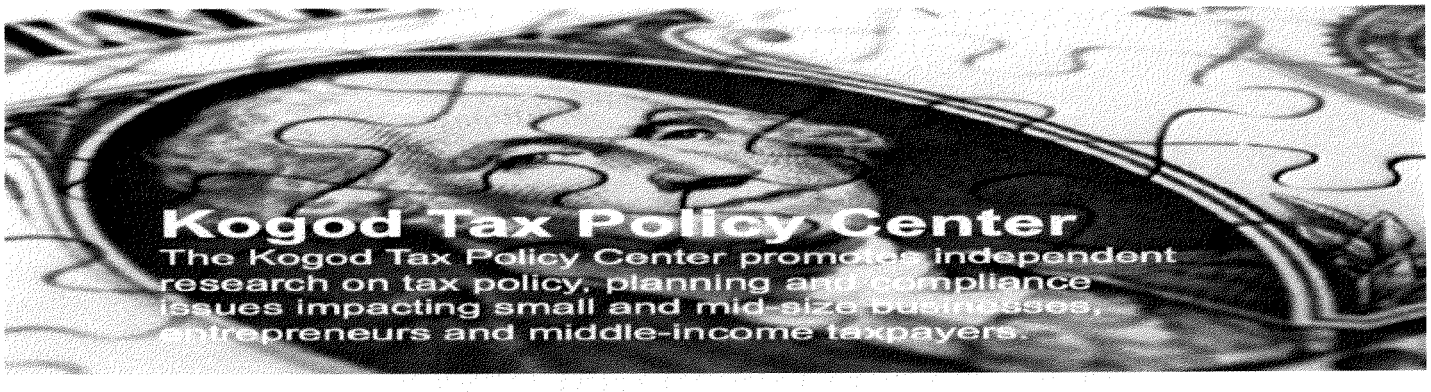
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2017 Tax Law – Impact on the Budget and American Families
Hearing of the United States House of Representatives Committee on the Budget
Wednesday, Feb. 27, 2019

Exhibit A to Written Testimony of Professor Caroline Bruckner,
Executive-in-Residence, Accounting and Taxation
Managing Director, Kogod Tax Policy Center
Kogod School of Business, American University
Feb. 27, 2019

KOGOD SCHOOL of BUSINESS
AMERICAN UNIVERSITY • WASHINGTON, DC

Background on Women Business Owners (WBOs)

- WBOs account for 40% of all U.S. firms and the total number of women-owned firms has increased over the last ten years by 58%
- WBOs are small businesses (99%) primarily operating as service firms (more than 60%) and continue to have challenges growing receipts and accessing capital.
- Women of color are the "driving force behind the growth of women-owned firms." Firms owned by women of color grew at a rate of 163% during the last 10 years and today, women of color own 64% of the new women-owned businesses launched each day.

The 2018 State of Women-Owned Businesses Report, Ventureer (2018), *available at* https://about.americanexpress.com/files/doc_library/file/2018-state-of-women-owned-businesses-report.pdf.

Industry Representation

- **Half of women-owned businesses** are concentrated in three industries: other services, health care and social assistance, and professional/scientific/technical services.
- Women are significantly **more likely to launch businesses** within the healthcare (10%) or education sectors (9%) than men (5% in both cases). In contrast, men are significantly more likely to start businesses in the construction and manufacturing industries (12%) than women (4%).
- Women-owned businesses **employ the most people** in healthcare and social assistance (20%), accommodations and food services (16%) and administrative, support and waste management services (13%).
- Women-owned businesses have the **highest total revenue** in wholesale trade (17%), retail trade (15%) and professional, scientific and technical services (10%).

Background on WBOs & Revenue

TABLE 1: 2012 CENSUS DATA ON WOMEN-OWNED FIRMS[39]		
Receipt/Revenue Size	**Number of Women-Owned Firms**	**Percent of Women-Owned Firms**
Total/2012 SBO Data	9,878,397	100%
less than $5,000	2,497,048	25.3%
$5,000 to $9,999	1,776,343	18.0%
$10,000 to $24,999	2,722,295	27.6%
$25,000 to $49,999	1,052,900	10.7%
$50,000 to $99,999	681,243	6.9%
$100,000 to $249,999	553,503	5.6%
$250,000 to $499,999	258,398	2.6%
$500,000 to $999,999	164,824	1.7%
$1,000,000 or more	171,842	1.7%

88.5%

JCT Distribution of 199A

Table 3.–Distribution of Tax Benefit for Pass-Through Deduction Under Section 199A

Income Category [1]	2018		2024	
	Returns (Millions)	$ Billions	Returns (Millions)	$ Billions
Less than $10,000	[2]	[3]	[2]	[3]
$10,000 to $20,000	0.5	-$0.1	0.6	-$0.1
$20,000 to $30,000	0.7	-$0.2	0.7	-$0.2
$30,000 to $40,000	0.8	-$0.2	0.8	-$0.3
$40,000 to $50,000	0.9	-$0.3	1.0	-$0.4
$50,000 to $75,000	2.5	-$1.0	2.6	-$1.3
$75,000 to $100,000	2.5	-$1.2	2.6	-$1.5
$100,000 to $200,000	6.2	-$6.3	6.5	-$8.0
$200,000 to $500,000	3.0	-$9.4	3.2	-$11.6
$500,000 to $1,000,000	0.2	-$3.6	0.3	-$5.3
$1,000,000 and over	0.2	-$17.8	0.2	-$31.6
Total, All Taxpayers	**17.4**	**-$40.2**	**18.4**	**-$60.3**

Table 3 of JCT's distributional analysis of 199A, more than 90% of the revenue loss generated from the new pass through deduction under IRC §199A will flow to firms with income of more than $100,000 in 2018 and 2024.

- JCT found in 2018, 44% of the IRC §199A revenue loss will flow to pass-through businesses with $1,000,000 of income. Moreover, JCT projects that the 44% revenue loss distribution will increase to 52% by 2024.
- 88% (or 10,775,600) of women business owners generate revenues less than $100,000. Only 1.7% of women-business owners have receipts of $1,000,000 or more

Joint Committee on Taxation, TABLES RELATED TO THE FEDERAL SYSTEM AS IN EFFECT 2017 THROUGH 2026 (JCX-32R-18), April 24, 2018.

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Pass-Through Deduction in 2017 Tax Law Could Weaken Wages and Workplace Standards

By Brendan Duke

A key provision of last year's tax law — a law that supporters claim will boost wages and create good jobs — may contribute to "workplace fissuring," which occurs when firms[1] acquire workers' services without employing them directly.[2] Examples include hiring truck drivers as independent contractors instead of as employees or hiring a janitorial services firm instead of hiring janitors directly. Workers employed in some of these arrangements tend to be paid less than workers that firms employ directly, extensive evidence shows. In fact, increasing evidence suggests that some types of workplace fissuring may contribute to growing compensation inequality.

The provision in question is the new 20 percent deduction for certain "pass-through" income — income that owners of businesses such as partnerships, S corporations, and sole proprietorships report on their individual tax returns, which previously was taxed at the same individual tax rates as their wage and salary income. The deduction reflects the tax law's three fundamental flaws: it is heavily tilted toward the wealthy, loses significant revenue at a time when the federal government needs additional revenue, and makes it easier for wealthy individuals to game the tax system.[3] Policymakers should be working to alleviate workplace fissuring and compensation inequality, but the pass-through deduction may encourage more of both in two basic ways:

- **Because it provides a tax break for independent contractors but not employees, employers can use it to entice new hires to accept independent contractor positions, even though the drawbacks for those workers could outweigh their tax gains.** The deduction results in a lower tax rate for business owners (including independent contractors) than for traditional employees. Workers may be more inclined to accept independent

[1] "Firm" here refers to both C-corporations and pass-throughs.

[2] This term comes from former U.S. Department of Labor official and Brandeis University Dean David Weil. Much of this paper draws on his book *The Fissured Workplace* (Harvard University Press, 2014).

[3] Chuck Marr, Brendan Duke, and Chye-Ching Huang, "New Tax Law Is Fundamentally Flawed and Will Require Basic Restructuring," Center on Budget and Policy Priorities, updated August 14, 2018, https://www.cbpp.org/research/federal-tax/new-tax-law-is-fundamentally-flawed-and-will-require-basic-restructuring.

contractor positions because of the deduction and employers may try to use it as a way to shift toward hiring independent contractors instead of traditional employees.

Importantly, many of the *disadvantages* of independent contractor status for workers are *advantages* for employers. Unlike employees, independent contractors don't enjoy legal protections regarding the minimum wage, overtime, sexual harassment, and workplace safety. Employers that provide benefits to employees such as health insurance typically don't provide them to independent contractors. And independent contractors must pay the employer's share of payroll taxes. Employers have an incentive to not disclose these drawbacks for employees or understate them relative to the deduction so that contractors won't try to negotiate higher pay to make up for them.

- **It could further encourage firms to adopt arrangements that push workers outside of direct employment, such as contracting out and franchising, which typically lead to lower wages and lower benefits for affected workers.** The profits of a contractor firm organized as a pass-through are eligible for the deduction, while a manager's salary is not. So, with the deduction, the owner-manager of a contractor firm can do the same work as an in-house manager and have the same take-home pay, even though the lead firm pays them less. In this way, the lead firm can capture a portion of the deduction's tax savings.

  Similarly, a firm may choose not to open a "branch" (where it employs a manager and workers) and instead expand with a "franchise" (where the manager owns the establishment and pays royalties to the original firm, and the remaining profits are eligible for the deduction). That way, the firm can effectively pay the franchise owner less than a manager without reducing the owner's after-tax income.

  Rank-and-file workers would remain traditional employees, but would work for the contractor firm or franchise instead of the lead firm. Considerable evidence suggests that contracting out and franchising lead to lower wages and benefits for workers.

Many tax experts across the political spectrum have already criticized the pass-through deduction because it taxes similar types of income at different rates based on arbitrary distinctions, many based on political influence rather than the economy's needs. An uneven playing field can create numerous distortions in individuals' and businesses' decisions, including those about how to classify and organize work. American Enterprise Institute economist Stan Veuger, for example, called the pass-through deduction "a particularly egregious form of industrial policy: not only does it select winning and losing industries, it also selects winning and losing organizational structures."[4] David Kamin, a tax and budget official in President Obama's White House and now a New York University Law

[4] Stan Veuger, "8 Ways to Improve the Tax Code," *National Interest*, January 25, 2017, https://nationalinterest.org/feature/8-ways-improve-the-tax-code-23963. See also Amanda Becker, "U.S. Republican tax law's pass-through deduction open to gaming - experts," Reuters, April 25, 2018, https://www.reuters.com/article/usa-tax-congress/u-s-republican-tax-laws-pass-through-deduction-open-to-gaming-experts-idUSKBN1HV2XW; Michael R. Strain, "To Help Families, Don't Cut Their Taxes," Bloomberg, November 8, 2017, https://www.bloomberg.com/view/articles/2017-11-08/to-help-families-don-t-cut-their-taxes.

School professor, termed it "one of the worst provisions that's been added into the tax code in the last several decades."[5]

The law's supporters may say the pass-through deduction's incentives for workplace fissuring encourage entrepreneurship. And, on paper, the deduction could create a large number of new businesses. But this is not the type of entrepreneurship that spurs innovation and job creation — instead, it would merely reflect firms breaking themselves into pieces to capture tax savings.[6] At the same time, federal tax policy is creating incentives that could push workers into employment arrangements that could further depress wages and weaken workplace standards, while creating significant costs and inefficiencies. Policymakers who want to increase entrepreneurship should instead focus on real barriers to it — as the Affordable Care Act (ACA) did by making affordable, quality health coverage more available in the marketplace, thus making it less risky for individuals to start their own businesses.[7]

There are no estimates to date of how much the 2017 tax law will drive fissuring or the exact forms it may take, especially as the IRS has only begun to issue guidance on what's eligible for the pass-through deduction. But the law's incentives for a shift toward independent contractors, contractor firms, and franchises appear straightforward, and the evidence showing that workers in some of these arrangements are paid less is significant. Rushing to enact the law, lawmakers did not even acknowledge this risk to workers.

The pass-through deduction has drawn criticism for its regressivity, cost, and potential for gaming the tax system. The fact that it also could also promote outsourcing, wage stagnation, and compensation inequality is another strong argument for its repeal.

Deduction Could Encourage Employees to Become Independent Contractors

The 2017 tax law lets business owners deduct 20 percent of certain pass-through income, effectively reducing the marginal individual tax rate on that income by one-fifth. Before the law, this income was taxed at the same individual tax rates as ordinary income, such as wages and salaries.

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[5] Chye-Ching Huang, "Senate Hearing Testimony Highlights 2017 Tax Law's Fundamental Flaws," Center on Budget and Policy Priorities, April 25, 2018, https://www.cbpp.org/blog/senate-hearing-testimony-highlights-2017-tax-laws-fundamental-flaws; Marr, Duke, and Huang.

[6] Shu Yi-Oei and Diane Ring of Boston College Law School examined the legal and other issues that could determine how much employment shifts toward independent contracting (but not contractor firms or franchises) as a result of the deduction. They concluded that much will depend on how the IRS and courts interpret the 2017 tax law and other statues as well as businesses' assessments of the risks, their industry's structures, and their willingness to change their relationship with workers. See Shu-Yi Oei and Diane M. Ring, "Is New Code Section 199A Really Going to Turn Us All into Independent Contractors?," Boston College Law School Legal Studies research paper, January 12, 2018, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3101180.

[7] Linda J. Blumberg, Sabrina Corlette, and Kevin Lucia, "The Affordable Care Act: Improving Incentives for Entrepreneurship and Self-Employment," Urban Institute, 2013, https://www.urban.org/research/publication/affordable-care-act-improving-incentives-entrepreneurship-and-self-employment.

Proponents claimed the deduction would create jobs by reducing tax rates on business owners,[8] but many self-employed independent contractors — such as freelance web designers or plumbers — are also eligible for it.[9] As a result, independent contractors are now taxed at a lower rate than employees who do the same work.[10] That creates a tax incentive for employees to become independent contractors.

For instance, by switching from employee to independent contractor status, a single earner making:[11]

- *$50,000 would get a tax cut of $900.* $50,000 is around the median annual salary of electricians ($54,100), plumbers ($52,600), and graphic designers ($48,700).[12]
- *$75,000 would get a tax cut of $2,800.* $75,000 is around the median annual salary of accountants ($69,400), architects ($78,500), and chemists ($74,700).
- *$120,000 would get a tax cut of $5,200.* $120,000 is around the median annual salary of lawyers ($119,300), pharmacists ($124,200), and computer hardware engineers ($115,100).[13]

Independent Contracting Has Significant Drawbacks for Workers

Recent IRS guidance on the pass-through deduction could make it hard for employees to switch to an independent contracting position with their *current* employers and receive the deduction. Yet, how the IRS enforces that restriction remains to be seen. As former Treasury Department official Adam Looney points out, "If you're an employee one year, and then a contractor the next year, will they [the IRS] actually know that?"[14]

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[8] U.S. House of Representatives Committee on Ways and Means, "Historic New Tax Relief to Help Main Street Job Creators," December 28, 2017, https://waysandmeans.house.gov/historic-new-tax-relief-help-main-street-job-creators/.

[9] Recent U.S. Bureau of Labor Statistics (BLS) data indicate that 6.9 percent of workers were independent contractors in 2017. That's a slight decline from the 7.4 percent figure for 2005, despite the recent attention to "gig economy" jobs (such as Uber drivers) in which workers are classified as independent contractors. The BLS data, however, measure what workers do for their main jobs; much of this work is likely done as a side job and so is not captured by the survey. See Annette Bernhardt, "Making Sense of the New Government Data on Contingent Work," Medium, June 10, 2018, https://blog.usejournal.com/making-sense-of-the-new-government-data-on-contingent-work-97209bb0c615.

[10] To be sure, as discussed below, independent contractors have to pay both the employer and employee portions of payroll taxes while employees only have to pay the employee portion. The payroll tax rate for employees and independent contractors is the same, however, if one considers the employer's portion of the tax a coming out of an employee's pre-tax compensation, as the employee typically "pays" the tax in the form of lower wages. See Jonathan Gruber, "The Incidence of Payroll Taxation: Evidence from Chile," *Journal of Labor Economics,* Vol., 15, No. 3, 1997, pp. 72-101.

[11] Calculations assume that these workers take the standard deduction.

[12] U.S. Bureau of Labor Statistics, Occupational Employment Statistics, May 2018, https://www.bls.gov/oes/.

[13] The potential tax savings are small for workers with low incomes since the pass-through deduction is limited to 20 percent of taxable income. A single earner making $16,000 in pass-through income (and no other income) who takes the $12,000 standard deduction only gets $80 of tax savings from the pass-through deduction.

[14] Brian Faler, "Pass-through regulations take aim at contracting gamesmanship," *Politico*, August 9, 2018, https://subscriber.politicopro.com/tax/whiteboard/2018/08/pass-through-regulations-take-aim-at-contracting-gamesmanship-1752512. Moreover, Congress has not increased the IRS's enforcement budget to deal with this and other enforcement challenges presented by the 2017 tax law: in 2018, it left enforcement at roughly the same level as in

Perhaps more importantly, the IRS guidance to date does nothing to limit the deduction for individuals who become independent contractors with *new* employers,[15] and workers on the job market may be more inclined to accept independent contractor status because of it. In response, employers could post new positions as independent contractor, instead of employee, positions. These new "independent contractor" positions may not actually meet the legal requirements for independent contractor status — which involves such issues as how much autonomy the worker has — but this type of misclassification is already pervasive, as discussed below.

There are many drawbacks for workers who become independent contractors, and these workers may underestimate them relative to the value of the pass-through deduction. For example, a wide array of labor protections does not apply to independent contractors, such as minimum wage and overtime laws, sexual harassment protections, and Occupational Safety and Health Administration (OSHA) regulations.[16] Nor do independent contractors qualify for programs such as workers' compensation and unemployment insurance.[17]

In theory, a worker considering an independent contractor position could negotiate higher compensation to offset the loss of these protections. But evidence suggests that a significant portion of *current* self-reported self-employed workers don't know that they don't have these protections: a study for the U.S. Labor Department found that over a third of workers who reported that they're self-employed thought they were eligible for the minimum wage, OSHA regulations, or Family and Medical Leave Act (FMLA) protections, even though self-employed workers are not eligible for any of them.[18]

Independent contractors also don't receive employer-provided benefits — e. g., health insurance, paid family and medical leave, vacation, retirement benefits, disability insurance, and long-term care insurance. Independent contractors must also pay the employer's half of payroll taxes. These are

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2017 and $1.5 billion (23 percent) below its 2010 level in inflation-adjusted terms. Emily Horton, "2018 Funding Bill Falls Short for the IRS," CBPP, March 23, 2018, https://www.cbpp.org/blog/2018-funding-bill-falls-short-for-the-irs.

[15] David Kamin, "Pass-Through Regulations: Doubling Down on Arbitrariness and Breaks for the Top," Medium, August 8, 2016, https://medium.com/whatever-source-derived/pass-through-regulations-7298efcfcb7a.

[16] Weil, p. 21; Sarah Leberstein and Catherine Ruckelshaus, "Independent Contractor vs. Employee: Why independent contractor misclassification matters and what we can do to stop it," National Employment Law Project, 2016, https://www.nelp.org/wp-content/uploads/Policy-Brief-Independent-Contractor-vs-Employee.pdf; Bryce Covert, "Actresses — and Millions of Other Workers — Have No Federal Sexual-Harassment Protections," *The Nation*, October 2017, https://www.thenation.com/article/actresses-and-millions-of-other-workers-have-no-federal-sexual-harassment-protections/. Employees who have been misclassified as independent contractors by their employers are still entitled to these protections. U.S. Government Accountability Office, "Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention," August 10, 2009, https://www.gao.gov/products/GAO-09-717.

[17] Weil, p. 21.

[18] Kelly Daley *et al.*, "Worker Classification Knowledge Survey Volume I—Technical Report," Abt Associates, November 16, 2016, https://www.dol.gov/asp/evaluation/completed-studies/Worker_Classification_Knowledge_Survey_Vol_1_Technical_Report.pdf; Abt Associates, "Understanding of Employee Protections," November 2016, https://www.dol.gov/asp/evaluation/completed-studies/Understanding_Of_Employee_Protections.pdf.

considerable sums: for each dollar that employers spend on wages, they spend (on average) another 36 cents on benefits and 11 cents on taxes and contributions to unemployment insurance and worker compensation programs.[19] Thus, an employee with a $50,000 salary could easily have a total compensation package of more than $73,000, when the cost of benefits and taxes are taken into account. Independent contractors could negotiate additional compensation to cover the cost of these items, but they may not know what they're worth — particularly benefits that typically cost more when purchased independently, like health insurance.[20]

Independent contractors have other burdens as well. They must calculate their taxes themselves and make quarterly payments to the IRS. (For most employees, their employers calculate their taxes and withhold them from their paychecks.) A recent examination of Uber drivers' online comments, however, found that many didn't understand that they must pay taxes on their payments from Uber.[21] Further, calculating these taxes can be complicated, especially since independent contractors have to track expenses and figure out which ones they can deduct.[22] Those who don't understand these rules or don't budget accordingly may face large tax bills when they file their tax returns, and they may have to pay penalties for not complying with the rules.[23]

Independent Contracting Has Significant Advantages for Employers

Many of the *disadvantages* for independent contractors (as discussed above) are *advantages* for employers. Employers are unlikely to fully disclose these disadvantages to workers weighing an independent contractor job or may say that the pass-through deduction will offset them, whether true or otherwise. Since many current self-employed workers don't understand these issues — and many people don't understand which financial decisions, on these and other complex matters, best serve their interests[24] — employers have the upper hand to use the pass-through deduction to rely more on independent contractors and cut their labor costs.

The employer benefits of relying on independent contractors are so substantial that many employers apparently already violate tax and labor laws by labeling workers who meet the legal

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[19] U.S. Bureau of Labor Statistics, "Table 1. Employer costs per hour worked for employee compensation and costs as a percent of total compensation: civilian workers, by major occupational and industry group," March 2018, https://www.bls.gov/news.release/ecec.t01.htm.

[20] Lily Batchelder and David Kamin, "The GOP tax plan creates one of the largest new loopholes in decades," *Los Angeles Times,* December 31, 2017, www.latimes.com/opinion/op-ed/la-oe-batchelder-kamin-tax-deduction-pass-through-income-20171231-story.html.

[21] Shu-Yi Oei and Diane M. Ring, "The Tax Lives of Uber Drivers: Evidence from Internet Discussion Forums," *Columbia Journal of Tax Law,* Vol. 8, 2017.

[22] The 2017 tax law also eliminates the ability to deduct tax preparation fees, making them more expensive for some filers.

[23] For more, see Kathleen DeLaney Thomas, "Tax Reform for the Gig Economy?," *Harvard Law Review* blog, October 17, 2018, https://blog.harvardlawreview.org/tax-reform-for-the-gig-economy/.

[24] For an exploration of some of the literature on the difficulty most people have making rational financial decisions, see The Committee for the Prize in Economic Sciences in Memory of Alfred Nobel, "Scientific Background on the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2017 Richard H. Thaler: Integrating Economics with Psychology," October 2017, https://assets.nobelprize.org/uploads/2018/06/advanced-economicsciences2017-1.pdf?_ga=2.81780823.1940396267.1536071873-1125184579.1536071873.

definition of employees as independent contractors. While "the national extent of employee misclassification is unknown;" a 2009 study by the Government Accountability Office (GAO) found, "... earlier and more recent, though not as comprehensive, studies suggest that it could be a significant problem with adverse consequences."[25] State government audits find that between 10 and 30 percent of audited employers misclassify employees as independent contractors.[26] Such misclassification potentially deprives millions of employees of the protections, benefits, and employer-paid taxes to which they're entitled.

Deduction Could Encourage Outsourcing to Contractor Firms and Franchises

The 20 percent deduction also creates incentives for companies to rely more on contractors and franchises. The profits of a contractor firm or franchise that's organized as a pass-through are eligible for the deduction, while the salary of the in-house manager of a company division or branch is not. That means, for example, that a manager who makes $150,000 a year can receive a $6,600 tax cut from becoming an owner-manager. Higher-salaried managers can receive even larger tax cuts: $20,200 for a manager making $300,000 and $34,200 for a manager making $500,000. To the extent that owner-managers of contractor firms and franchises effectively share the tax savings with the lead firm, as explained below, these forms of workplace fissuring will become more attractive to lead firms.

Contractor Firms

Outsourcing to contractor firms occurs when a company contracts to obtain the services of workers from another firm. No one knows definitively how widespread this phenomenon is, but research indicates that it's prevalent and growing.[27] One study estimates that the share of all workers employed in "business service firms" — firms that provide services to other firms — grew from under 2 percent in 1950 to over 8 percent in 2015.[28] Even more striking, it found that, over the same period, the share of cleaning and janitorial service workers employed by such firms grew from 2 percent to over 25 percent and the share of security workers rose from 3 percent to 35 percent.

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[25] U.S. Government Accountability Office, 2009.

[26] National Employment Law Project, "Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries," 2015, https://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-on-workers-and-federal-and-state-treasuries/.

[27] The Bureau of Labor Statistics Survey on Contingent Workers and Alternative Employment Arrangements found a very small share of workers employed by contractor firms, but experts on the topic do not believe that the BLS estimate captures the full scope of such arrangements since the survey asks about work for only one type of contractor firm: firms that work on-site at the client firm and for one client. Workers for contractor firms may work for multiple clients (as may be the case for a janitor) or offsite (as may be the case at a call center). Moreover, some workers may not be able to accurately identify their employer. See Bernhardt 2018. For a look at the issues in measuring contract employment and other forms of fissured work, see Annette Bernhardt *et al.*, "Domestic Outsourcing in the United States: A Research Agenda to Assess Trends and Effects on Job Quality," Upjohn Institute, Upjohn Institute Working Paper 16-253, 2016, http://research.upjohn.org/up_workingpapers/253/.

[28] David Dorn, Johannes F. Schmieder and James R. Spletzer, "Domestic Outsourcing in the United States," unpublished, January 31, 2018, https://www.dol.gov/asp/evaluation/completed-studies/2016-2017-Scholars-Program/Domestic-Outsourcing-in-the-United-States.pdf.

Another study found that the share of workers in computer occupations employed by business-services firms grew from 39 percent in 1990 to over 50 percent a decade later.[29]

A study by a Bureau of Labor Statistics economist measures outsourcing by calculating the concentration of workers in the same occupation at the same worksite, because such concentration makes it likelier that these workers work for a contractor rather than a lead firm. For example, an IT worker employed at a workplace where most other workers also are IT workers is likelier working for an IT contractor than one who works at a worksite where workers have a wide range of occupations. The study finds this type of concentration grew between 1999 and 2015.[30] Bloomberg recently reported that contractors at Alphabet Inc., the parent company of Google, outnumber direct employees.[31]

The pass-through deduction could prompt even more firms to embrace these arrangements. Consider a firm deciding whether to retain its 20-person IT department or hire an outside contractor firm to provide 20 IT staff to do the same work with the same management structure. The IT department has five managers: one makes $300,000 and four make $150,000, for a total cost of $900,000. They aren't eligible for the pass-through deduction. The owner-managers of the contractor firm, however, are eligible for it. The latter can earn the same take-home pay as the in-house managers while only charging the firm about $839,000 — 7 percent less — for their services because of their lower tax rate from the pass-through deduction. That enables the contractor firm to charge a lower price, effectively sharing some of the tax savings with the lead firm in order to win its business.[32]

Franchises

Under franchising, a lead firm sells an independent business owner the right to use its name, techniques, materials, and more in operating a business. Again, we have no good estimate of the share of workers employed by franchises, but the trade association representing franchises says that 8 million people work for franchises, and it expects franchise employment to grow twice as quickly as overall employment in 2018.[33]

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[29] Matthew Dey, Susan N. Houseman, and Anne E. Polivka, "What Do We Know about Contracting Out in the United States? Evidence from Household and Establishment Surveys," *Labor in the New Economy*, eds. Katharine G. Abraham, James R. Spletzer, and Michael J. Harper (University of Chicago Press, 2010), pp. 267-304.

[30] Elizabeth Weber Handwerker, "Increased Concentration of Occupations, Outsourcing, and Growing Wage Inequality in the United States," unpublished, April 2017, http://www.sole-jole.org/17733.pdf.

[31] Mark Bergen and Josh Eidelson, "Inside Google's Shadow Workforce," Bloomberg, July 25, 2018, https://www.bloomberg.com/news/articles/2018-07-25/inside-google-s-shadow-workforce.

[32] For the purposes of this section, we assume that the managers have negotiated sufficient additional compensation to make up for the loss of their own benefits mentioned above. Their failure to do so would add to the potential employer savings from outsourcing.

[33] IHS Markit, "Franchise Business Economic Outlook for 2018," January 2018, https://franchiseeconomy.com/files/Franchise_Business_Outlook_Jan_2018.pdf. The federal government stopped tracking data on franchising in the 1980s. See Francine LaFontaine and Roger D. Blair, "The Evolution of Franchising and Franchise Contracts: Evidence from the United States," *Entrepreneurial Business Law Journal*, Vol. 3, 2009, pp. 381-434.

The pass-through deduction encourages franchising because it enables a lead firm to generate cost savings similar to those described above. Instead of opening its own branch with its own workers, the lead firm can open a franchise where one or more managers own the new establishment but pay a royalty to the lead firm's owners. The lead firm can set the royalty so that the firm is effectively paying the franchise owners less than if they were in-house managers, even though the after-tax earnings of both are the same because of the deduction.

Contracting and Franchising Can Harm Rank-and-File Workers

The incentives for lead firms to rely more on outsourcing to contractor firms or expand through franchises also affect rank-and-file workers: rather than work for lead firms, they would work for the contractor firm or franchise. Many of them could end up worse off, with lower wages and fewer benefits.

Outsourcing reduces wages by 4-7 percent for janitors and by 8-24 percent for security guards, while reducing health insurance benefits for both, one study found.[34] Other studies have found similar results.[35] These workers also may have fewer chances for training or career advancement.[36] Labor-law violations are more common at restaurants and hotels that are franchises. Franchise-owned fast-food restaurants were 24 percent likelier to violate labor laws than those owned by the lead firm and the back wages they owed workers were 50 percent higher per violation, one analysis found.[37]

Pay and benefits tend to be lower at franchises or contractor firms for several reasons, including:

- Inequality among a firm's employees can reduce productivity and morale,[38] so large profitable firms may choose to pay above-market wages to their lower-wage employees to reduce inequality within the firm. These firms, however, can cut labor costs *without* increasing inequality within the firm by moving these jobs to a contractor or a franchise paying lower wages.

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[34] Arindrajit Dube and Ethan Kaplan, "Does Outsourcing Reduce Wages in the Low-Wage Service Occupations? Evidence from Janitors and Guards," *Industrial Labor Relations Review*, Vol. 63, No. 2, 2010.

[35] Katharine G. Abraham and Susan K. Taylor, "Firms' Use of Outside Contractors: Theory and Evidence," *Journal of Labor Economics*, Vol. 14, No. 3, 1996, pp. 394-424; Samuel Berlinski, "Wages and Contracting Out: Does the Law of One Price Hold?," *British Journal of Industrial Relations*, Vol. 46, No. 1, 2008, pp. 59-75; Dorn, Schmieder, and Spletzer.

[36] The recent decline in employer-sponsored training may partly reflect workplace fissuring. C. Jeffrey Waddoups, "Did Employers in the United States Back Away from Skills Training During the Early 2000s?," *Industrial and Labor Relations Review*, Vol. 69, No. 2, 2016, pp. 405-434.

[37] Weil, pp. 122-158; David Weil and Min Woong Ji, "Does Ownership Structure Influence Regulatory Behavior? The Impact of Franchising on Labor Standards Compliance," *Industrial and Labor Relations Review*, Vol. 68, No. 5, 2015, pp. 977-1006.

[38] Weil 2014; George A. Akerlof and Janet L. Yellen, "The Fair Wage-Effort Hypothesis and Unemployment," *Quarterly Journal of Economics*, Vol. 105, No. 2, 1990, pp. 255-283; Truman Bewley, *Why Wages Don't Fall During a Recession?* (Harvard University Press, 1999); Arindrajit Dube, Laura Giuliano, and Jonathan Leonard, "Fairness and Frictions: The Impact of Unequal Raises on Quit Behavior," IZA Discussion Paper 9149, June 2015, https://www.iza.org/publications/dp/9149/fairness-and-frictions-the-impact-of-unequal-raises-on-quit-behavior.

- Firms have limited authority, under the law, to offer benefits such as health insurance or paid leave to some employees but not others.[39] By using franchises or contractor firms, lead firms can eliminate benefits for certain groups of workers by shifting those jobs outside the firm.
- Franchises and contractors make it easier for a lead firm to avoid various labor protections. Lead firms can set a contractor firm's prices so low, or a franchise's royalties so high, that they may find it hard to make a profit without violating some labor laws. The lead firm, meanwhile, avoids the legal or reputational liability from such violations.[40] Lead firms also can use contractors to avoid having a unionized workforce, which would cost more.[41]

Workplace Fissuring May Be Increasing Wage Inequality

Workplace fissuring may have contributed to the increase in wage inequality over the last few decades, growing evidence suggests:

- One study found that about two-thirds of the increase in earnings inequality between 1978 and 2013 reflects growing inequality between workers at different firms, as opposed to workers at the same firm.[a] The authors tied most of this increase to high-earning workers increasingly working at firms that pay higher average wages, and being increasingly less likely to work with low-wage workers. Another paper found similar results among worksites.[b] That's consistent with the idea that large, profitable firms increasingly outsource the services of low- and middle-wage workers, pushing them into low-wage firms that pay lower wages.
- A study about Germany found that when employers outsource jobs, wages fall 10-15 percent compared to similar jobs that weren't outsourced.[c] It also found that the outsourcing of cleaning, security, and logistics services alone accounts for about 10 percent of the increase in German wage inequality since the 1980s. A preliminary study using the same methodology also found wage declines in the United States that resulted from outsourcing.[d]
- The study, noted above, which found an increase in outsourcing between 1999 and 2015 – measured by the concentration of workers in the same occupation at the same worksite[e] – also determined that this growing occupational concentration helps explain a substantial portion of growing wage inequality over that period.

[a] Jae Song *et al.*, "Firming Up Inequality," forthcoming *Quarterly Journal of Economics*, https://fguvenendotcom.files.wordpress.com/2018/09/fui_qje_accepted.pdf.

[b] Erling Barth *et al.*, "It's Where You Work: Increases in the Dispersion of Earnings across Establishments and Individuals in the United States," *Journal of Labor Economics*, Vol. 34, No. 2, 2016.

[c] Deborah Goldschmidt and Johannes F. Schmieder, "The Rise of Domestic Outsourcing and the Evolution of the German Wage Structure," *Quarterly Journal of Economics*, Vol. 132, No. 3, 2017, pp. 1165-1217.

[d] Dorn, Schmieder, and Spletzer.

[e] Handwerker.

[39] Weil, p. 78.

[40] Weil, pp. 105, 112, 139-142.

[41] Weil, pp. 101-107.

Pass-through Deduction's Guardrails Won't Prevent Workplace Fissuring

Under last year's tax law, the pass-through deduction has "guardrails" that appear intended to prevent workers from recharacterizing their wages and salaries to get the deduction. But they may turn out to be largely ineffective at preventing workplace fissuring.[42]

One guardrail, for example, denies the deduction to individuals in certain "personal services" industries (such as medicine, law, accounting, consulting, financial services, and athletics) if they make over $157,500 ($315,000 for a married couple). But the overwhelming majority of workers make less than $157,500 (including most accountants and lawyers) and could therefore become independent contractors regardless of industry.[43] The owner of a contractor firm or franchise, by contrast, would be likelier to have an income above the thresholds. But the list of industries in which high earners cannot get the deduction omits many industries that are especially likely to include contractor firms, such as IT and payroll. Moreover, franchising could spread in the long list of industries that are eligible for the deduction.

Another guardrail limits the size of the deduction for high-income business owners to a percentage of the wages the firm pays or the value of the property it owns. But that won't likely prevent many contract firm or franchise owners from receiving the full deduction, as the thresholds are relatively high. This guardrail only limits the deduction if the firm's profits are more than 250 percent as large as the wages the firm pays (a firm that does not meet this requirement can use another formula that also includes the value of property in addition to wages).[44] Yet, the average S-corporation's profits are only 61 percent as large as the wages it pays, according to IRS data.[45] In the administrative and support services industry — the industry many contractor firms likely fall under — the average S-corporation's profits are only 25 percent as large as the wages it pays. In those cases when the wage guardrail is binding, an S-corporation's owners can increase the wages they pay themselves in order to increase the deduction allowed for the remaining profits.[46]

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[42] It's hard to know what the authors of the 2017 tax law intended because of "the lack of any underlying logic in deciding who benefits from the pass-through deductions, and who does not." David Kamin *et al.*, "The Games They Will Play: An Update on the Conference Committee Tax Bill," SSRN, December 28, 2017, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3089423.

[43] In fact, 90 percent of workers make less than $96,000. U.S. Bureau of Labor Statistics, "Occupational Employment Statistics," 2018. For the other professions, see the median salary numbers cited above.

[44] A firm's high-income owner can receive the full deduction equal to 20 percent of profits if that amount is equal to 50 percent of the wages it pays and it is not in one of the industries denied the deduction. The owner of a firm with $1 million in profits can, therefore, receive the full $200,000 deduction if the firm pays at least $400,000 in wages.

[45] IRS Statistics of Income, Table 1, "S Corporations: Total Receipts and Deductions, Portfolio Income, Rental Income, and Total Net Income, by Major Industry Tax Year 2013," https://www.irs.gov/statistics/soi-tax-stats-table-1-returns-of-active-corporations-form-1120s. These figures compare "wages and salaries" to "total net income (less deficit)." They do not include "compensation of officers" — if they did, profits would be even smaller compared to wages.

[46] Martin Sullivan, "Economic Analysis: A Dozen Ways to Increase the TCJA Passthrough Benefits," *Tax Notes*, April 9, 2018, https://www.taxnotes.com/tax-notes/partnerships-and-other-passthrough-entities/economic-analysis-dozen-ways-increase-tcja-passthrough-benefits/2018/04/09/27y53.

Recent IRS guidance may actually *encourage* contracting out. Last year, tax experts identified a strategy known as "cracking" by which high earners could potentially receive the deduction, even in industries that are not supposed to be eligible.[47] Under it, a firm can split itself into pieces, and income from the pieces that aren't in industries barred from getting the deduction could get it. A law firm, for example, could spin off its payroll department into a separate company that charges the law firm for its payroll services. This payroll service income would then be eligible for the deduction, while the law firm's income from legal work would not. The recent IRS guidance rightfully makes it harder for firms to crack but does nothing to prevent firms from capturing tax savings by contracting out. (The difference is that under cracking, the owners of the original firm typically own each of the pieces, unlike with contracting.) Thus, the IRS guidance makes contracting out more attractive.[48]

Deduction an Inefficient Way to Increase Entrepreneurship

Together, the pass-through deduction's tax incentive for workplace fissuring and the failure of its guardrails to prevent it could shift employment further toward independent contracting, contractor firms, and franchises. On paper at least, that could mean a large number of new businesses. Yet that's hardly the sort of entrepreneurship that leads to innovation and job creation. Instead, it just means that existing firms are splitting up to capture the tax savings created by the deduction (thereby costing more in reduced federal revenue) and, in some cases, also to reduce their labor costs (thereby increasingly putting downward pressure on wages).

Many economists across the political spectrum view the pass-through deduction as unwarranted and inefficient for various reasons. This aspect of the deduction — the shift to fissured work — may compound the economic inefficiency. Firms may further shift their employment practices toward these arrangements to secure the tax cut. But part of these gains may be offset by inefficiencies that fissuring can produce. Firms surrender control over their workers when they no longer employ them directly; they may, for example, be less able to maintain product quality and prevent delays.[49] Technological and organizational innovations have made it easier for lead firms to maintain control, but until now they have only needed to weigh fissuring's labor savings against its potential inefficiencies. The pass-through deduction, however, effectively puts a thumb on the scale in favor of fissuring by offering tax savings as well.

Rather than create an inefficient tax break that increases inequality, policymakers who want to boost entrepreneurship should focus on real barriers to entrepreneurship. The ACA, for example, did that by enabling millions of Americans to obtain affordable, quality health coverage in the marketplace *independent of an employer,* making it less costly and risky for them to start their own small

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[47] Kamin *et al.*

[48] Kamin.

[49] Weil, p. 60. See also Oliver Williamson, "The Theory of the Firm as Governance Structure: From Choice to Contract," *Journal of Economic Perspectives,* Vol. 16, No. 3, 2002, pp. 171-195; Ronald Coase, "The Nature of the Firm," *Economica,* Vol. 4, No. 16, 1937, pp. 386-405.

business. The ACA's marketplace reforms mean that 1.5 million more people are self-employed than otherwise, Urban Institute and Georgetown University health researchers estimate.[50]

The 2017 tax law itself threatens to reverse at least some of these gains for some small business owners and self-employed people by repealing the ACA's individual mandate; the Congressional Budget Office estimates that that will increase health insurance premiums in the individual market by 10 percent.[51] Small business owners and the self-employed disproportionately rely on this market. The higher costs may not just hurt them financially but could also encourage them to become traditional employees at a firm that offers health care, even if they would prefer to own their own businesses or work for themselves.

Conclusion: Pass-Through Deduction May Further Encourage Harmful Labor Market Trend

The implications of fissured workplaces for workers have received increased attention in recent years. In some cases, policymakers have acted to counter this trend or mitigate its effects. The Obama Administration, for example, issued a rule (known as a "joint employer standard") on whether a lead firm has responsibility to comply with labor law when it directs a group of workers employed by another firm.[52] The Obama Administration also made it harder for firms to misclassify employees as independent contractors,[53] and it attempted to update federal overtime rules so that they covered more workers.[54] The Trump Administration has sought to reverse progress in these areas by rescinding or re-writing those rules.[55]

In short, the new pass-through deduction moves tax policy in the wrong direction. It may push more workers into low-wage firms or put them outside the protections of labor laws, while weakening their employer-provided benefits. That's one more reason that policymakers should undo this serious policy mistake and repeal the pass-through deduction.

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[50] Blumberg, Corlette, and Lucia, 2013.

[51] Congressional Budget Office, "Repealing the Individual Health Insurance Mandate: An Updated Estimate," November 8, 2017, https://www.cbo.gov/publication/53300.

[52] U.S. Department of Labor, "Joint employment under the Fair Labor Standards Act and Migrant and Seasonal Agricultural Worker Protection Act," 2016, http://www.fissuredworkplace.net/assets/Administrator_Interpretation_on_Joint%20Employment_2016.pdf.

[53] U.S. Department of Labor, "The Application of the Fair Labor Standards Act's 'Suffer or Permit' Standard in the Identification of Employees Who Are Misclassified as Independent Contractors," 2015, http://www.fissuredworkplace.net/assets/Administrator_Interpretation_on_Misclassification_2015.pdf.

[54] Alana Semuels, "The Future of the Department of Labor Under Trump," *The Atlantic*, March 6, 2017, https://www.theatlantic.com/business/archive/2017/03/the-department-of-labor-under-trump/518307/.

[55] Ben Penn, "Outlook 2018: Trump Labor Dept. Looks to Move Agenda Forward in Year Two," Bloomberg BNA, January 2, 2018, https://www.bna.com/outlook-2018-trump-n73014473725/.