ANALYSIS OF THE PROTECTING FAMILY AND SMALL BUSINESS TAX CUTS ACT OF 2018

Jeffrey Rohaly, Joseph Rosenberg, Benjamin R. Page, and Daniel Berger

September 12, 2018

The Protecting Family and Small Business Tax Cuts Act of 2018 extends major individual income and estate tax provisions from 2017's Tax Cuts and Jobs Act that are currently scheduled to expire at the end of 2025. The bill would reduce federal revenues by $631 billion within the budget window (fiscal years 2019–28) and by almost $3.2 trillion over the subsequent decade (fiscal years 2029–38). In 2026, taxes would decline on average across all income groups, but higher income households would generally receive larger average tax cuts as a percentage of after-tax income. About two-thirds of taxpayers would receive a tax cut and about 9 percent would face a tax increase.

On September 10, 2018, Chair of the House Ways and Means Committee Kevin Brady released the Protecting Family and Small Business Tax Cuts Act of 2018.[1] The bill extends individual income and estate tax provisions that were included in the 2017 tax act, the Tax Cut and Jobs Act (TCJA), and are scheduled to expire at the end of 2025.

Specifically, the bill would make permanent the following provisions of the TCJA by:[2]

- **Individual income tax rates and brackets**: Lowering statutory marginal income tax rates to 10, 12, 22, 24, 32, 35, and 37 percent and adjusting some bracket thresholds.

- **Alternative minimum tax**: Increasing the exemption levels and phaseout thresholds.

[1] A complete description of the bill prepared by the Staff of the Joint Committee on Taxation is available at: https://www.jct.gov/publications.html?func=startdown&id=5134.

[2] More detail about the provisions of the TCJA can be found in Gale, Gelfond, Krupkin, Mazur, and Toder (2018), "Effects of the Tax Cuts and Jobs Act: A Preliminary Analysis."

- **Standard deduction**: Roughly doubling the standard deduction amounts.

- **Personal exemptions**: Eliminating personal exemptions for taxpayers and dependents.

- **Pass-through income**: Allowing a 20 percent deduction for qualifying pass-through income (e.g., from sole proprietorships, partnerships, limited liability companies, and S corporations), and disallowing certain pass-through losses.

- **Child tax credit**: Increasing the child tax credit for qualifying children under 17 to $2,000 (partially refundable), allowing for a $500 nonrefundable credit for other dependents, and increasing the phaseout thresholds to $200,000 ($400,000 for joint filers).

- **Itemized deductions**: Limiting the itemized deduction for state and local taxes paid to $10,000 (not indexed for inflation) for all filers, reducing the amount of debt eligible to claim a mortgage interest deduction, eliminating the itemized deduction for certain miscellaneous expenses, and repealing the overall limitation on itemized deductions (the Pease limitation).

- **Estate tax**: Doubling the estate, gift, and generation-skipping-transfer tax exemption amount.

REVENUE EFFECTS

The Protecting Family and Small Business Tax Cuts Act of 2018 would reduce federal tax revenues by $631 billion over the 10-year budget period (fiscal years 2019 through 2028) according to official estimates released by the Joint Committee on Taxation. Because the budget period ends with fiscal year 2028, however, that loss reflects fewer than three calendar years of the extension. The bill would reduce revenues by $268 billion in fiscal year 2028 alone, according to the Joint Committee on Taxation.

The Tax Policy Center estimates that the bill would reduce federal revenues by $3.15 trillion over the following decade under conventional scoring (table 1). That corresponds to 0.8 percent of GDP and 4.5 percent of projected federal revenues over the same period. Nearly 95 percent of the loss would come from reduced individual income tax receipts; estate and gift tax changes would account for the rest.

TABLE 1

Revenue Effects of the Protecting Family and Small Business Tax Cuts Act of 2018

Billions of dollars, fiscal years 2019–38

Provision	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2019–28	2029–38
Change income tax rate brackets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-126.6	-188.5	-197.9	-513.0	-2,505.4
Modify individual alternative minimum tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-34.4	-115.6	-119.9	-269.9	-1,638.8
Increase standard deduction	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-71.0	-104.2	-108.1	-283.3	-1,293.4
Repeal personal exemptions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	123.7	181.6	188.1	493.5	2,290.4
Allow 20% deduction of qualified business income	0.0	0.0	0.0	0.0	0.0	0.0	-6.1	-40.5	-74.3	-77.1	-198.1	-977.0
Disallow certain active pass-through losses	0.0	0.0	0.0	0.0	0.0	0.0	0.0	10.8	18.5	19.1	48.3	247.7
Modify child tax credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-39.0	-85.5	-87.3	-211.8	-949.9
Modify itemized deductions	-0.4	-1.8	-1.6	0.0	0.0	0.0	0.0	73.3	120.1	124.3	313.9	1,830.2
Change from all other provisions[a]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.6	2.3	2.4	6.2	28.1
Double estate, gift, and GST tax exemption amount	0.0	0.0	0.0	0.0	0.0	-0.1	-0.4	-1.2	-12.2	-14.5	-28.4	-182.5
TPC total with conventional scoring	**-0.4**	**-1.8**	**-1.6**	**0.0**	**0.0**	**-0.1**	**-6.4**	**-103.3**	**-257.9**	**-271.0**	**-642.4**	**-3,150.5**
Memo: Official revenue estimate from JCT	*-0.4*	*-2.0*	*-1.6*	*0.0*	*0.0*	*-0.1*	*-6.1*	*-102.4*	*-250.4*	*-268.0*	*-630.9*	
Macroeconomic feedback on revenues	0.1	0.1	0.0	0.0	0.0	0.0	0.7	22.9	25.3	21.8	70.8	156.9
TPC total with macroeconomic feedback	**-0.3**	**-1.8**	**-1.6**	**0.0**	**0.0**	**-0.1**	**-5.8**	**-80.4**	**-232.6**	**-249.2**	**-571.7**	**-2,993.6**

Sources: Urban-Brookings Tax Policy Center (TPC) Microsimulation Model (version 0718-1), TPC's macroeconomic models, and TPC calculations based on JCT estimates.
Note: AMT = alternative minimum tax; GST = generation-skipping transfer; JCT = Joint Committee on Taxation.

(a) Excludes minor changes to capital gains tax bracket thresholds and indexation and rounding of individual income tax bracket thresholds.

Incorporating Macroeconomic Effects (Dynamic Scoring)

TPC projects the bill would have little effect on the economy through 2025, but would increase GDP by about 0.5 percent in 2026, 0.4 percent in 2028, and 0.1 percent in 2038. The increase in output results primarily from lower tax rates on labor and capital income relative to current law levels after 2025. Those changes would increase incentives for work and saving, boosting GDP, but those positive impacts are offset over time as increased deficits crowd out private investment. The bill would also boost output slightly in 2026 by eliminating the negative effect of the expiring tax cuts on aggregate demand.

The resulting macroeconomic feedback would boost revenues by a cumulative total of $71 billion over 2019–28, and by $157 billion over 2029–38, offsetting a modest portion of the revenue loss as projected under conventional scoring (table 1).

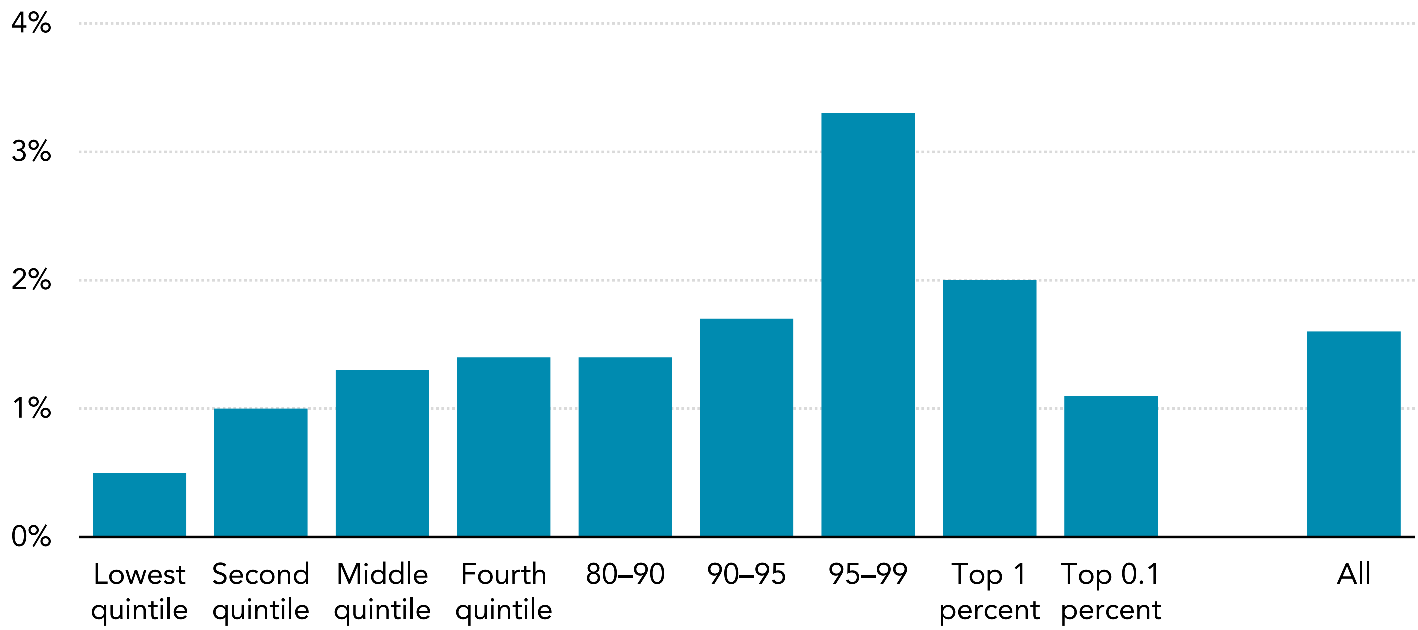
DISTRIBUTIONAL EFFECTS

In 2026, taxes would be reduced by about $1,600 on average under the bill, increasing after-tax incomes 1.6 percent (table 2). Taxes would decline on average across all income groups, but higher income households would generally receive larger average tax cuts as a percentage of after-tax income (figure 1).

FIGURE 1

Percent Change in After-Tax Income from the Protecting Family and Small Business Tax Cuts Act of 2018

By expanded cash income percentile, 2026



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0718-1).

Taxpayers in the bottom quintile would see an average tax cut of $100, or 0.5 percent of after-tax income. Taxpayers in the middle income quintile would receive an average tax cut of $980, or 1.3 percent of after-tax income. Taxpayers in the 95th to 99th income percentiles would benefit the most as a share of after-tax income, with an average tax cut of almost $15,000, or 3.3 percent of after-tax income. Taxpayers in the top 1 percent of the income distribution would receive an average cut of about $40,000, or 2.0 percent of after-tax income.

However, not all taxpayers would see their taxes decline. About two-thirds of taxpayers would receive a tax cut, averaging about $2,900. Nine percent would face an average tax increase of about $3,800, primarily because of lost personal exemptions and the limit on deductions for state and local taxes and other itemized deductions. In the bottom income quintile, 32 percent would receive a tax cut and 2 percent would face a tax increase. In the middle income quintile, 81 percent would receive a tax cut and 11 percent would face a tax increase. In the 95th to 99th income percentiles, 91 percent would receive a tax cut and 8 percent would face a tax increase. In the top 1 percent, 77 percent would receive a tax cut and 22 percent would face a tax increase.

TABLE 2

Distribution of Federal Tax Change from the Protecting Family and Small Business Tax Cuts Act of 2018

By expanded cash income percentile, 2026[a]

Expanded cash income percentile[b]	Tax units with tax cut or increase[c]				Percent change in after-tax income[d]	Share of total federal tax change	Average federal tax change	Average federal tax rate[e]	
	With tax cut		With tax increase					Percentage-point change	Under the proposal
	Percent of tax units	Average tax change	Percent of tax units	Average tax change					
Lowest quintile	32.2	-360	1.6	810	0.5	1.6	-100	-0.5	3.2
Second quintile	67.7	-770	6.2	840	1.0	6.3	-470	-1.0	8.2
Middle quintile	81.4	-1,380	11.4	1,270	1.3	12.3	-980	-1.1	13.2
Fourth quintile	84.4	-2,430	14.4	1,870	1.4	18.8	-1,780	-1.2	16.7
Top quintile	85.2	-10,050	14.2	10,020	2.1	63.0	-7,140	-1.5	24.4
All	**66.2**	**-2,930**	**8.6**	**3,810**	**1.6**	**100.0**	**-1,610**	**-1.3**	**19.0**
Addendum									
80–90	84.0	-3,670	15.4	2,450	1.4	12.4	-2,710	-1.1	19.5
90–95	84.7	-5,870	14.7	2,750	1.7	10.1	-4,570	-1.3	21.2
95–99	91.1	-16,910	8.4	7,960	3.3	24.4	-14,730	-2.4	24.0
Top 1 percent	77.6	-80,090	21.6	101,860	2.0	16.2	-40,180	-1.3	31.3
Top 0.1 percent	64.2	-405,730	34.7	447,830	1.1	4.3	-105,320	-0.8	32.6

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0718-1).

Notes: Number of alternative minimum tax taxpayers (millions): baseline: 7.1; proposal: 0.2. Itemizers (millions): baseline: 52.5; proposal: 24.4.

(a) Calendar year. Baseline is current law. Proposal includes provisions contained in H.R. 6760, Protecting Family and Small Business Tax Cuts Act of 2018 as considered by the House Ways and Means Committee. Excludes certain minor provisions including: repeal of exclusion for employer-provided moving expense reimbursements; repeal of exclusion for employer-provided bicycle commuter fringe benefits; limitation on wagering losses; and minor changes to tax bracket thresholds.

(b) Percentiles include both filing and nonfiling units but excludes those that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. 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 (in 2018 dollars): 20% $28,600; 40% $54,800; 60% $95,000; 80% $168,600; 90% $244,100; 95% $357,300; 99% $836,200; 99.9% $3,920,200. For a description of expanded cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm .

(c) Includes tax units with a change in federal tax burden of $10 or more in absolute value.

(d) After-tax income is expanded cash income less total federal tax (individual and corporate income taxes, payroll taxes, estate tax, and excise taxes).

(e) Average federal tax as a percentage of average expanded cash income.