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## Revising the Tax Law: The TCJA and its Place in the History of Tax Reform

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## Revising the Tax Law: The TCJA and its Place in the History of Tax Reform

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## 42nd Annual Symposium Articles

### Revising the Tax Law: The TCJA and its Place in the History of Tax Reform

JENNIFER BIRD-POLLAN\*

#### INTRODUCTION

Tax reform in the United States seems like a nearly unending process. Despite this nearly constant tweaking of the law, there has not been a major revision of the tax law in the U.S. since the bipartisan efforts that led to the 1986 tax reform.<sup>1</sup> The law known as the Tax Cuts and Jobs Act (or “TCJA”) of 2017 (which most commentators continue to call it, and which title I will use here, although the title was not formally enacted as part of the bill, leaving the bill without an official name) represents the first major piece of tax legislation in over 30 years.<sup>2</sup> Given the significance of the reform, and the unusual way in which it was passed, the TCJA deserves careful consideration, both as an item of tax history, and in detail as a major revision of the United States income tax law. This Article contributes to this project and proceeds as follows: Part I places the TCJA in the context of tax reform history in the United States; Part II explains the history of the TCJA; Part III breaks down

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1. Samuel A. Donaldson, *Understanding the Tax Cuts and Jobs Act*, GA. ST. UNIV. COLL. OF LAW 1 (Jan. 3, 2018), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3096078](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3096078) (“Signed by President Trump on December 22, 2017, Public Law 115-97, formally titled ‘An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018’, but commonly known as the ‘Tax Cuts and Jobs Act,’ represents the most dramatic change to the Internal Revenue Code since passage of the Tax Reform Act of 1986.”).

2. *Id.*

the component parts of the TCJA and analyzes those parts; Part IV discusses estimates regarding the distributional effects of the tax law reform; and Part V concludes.

#### PART I: HISTORY OF TAX REFORM IN THE UNITED STATES

While the income tax may now seem like an inevitable part of the landscape in the United States, affecting all citizens, and even some non-citizens, and creating an annual ritual of tax filing for Americans across the socio-economic spectrum, it was not always so. Indeed, in its earliest instantiation, the income tax in the United States was primarily aimed at the highest income taxpayers, and was enacted in the context of wartime as a way to raise funds for war efforts.<sup>3</sup> Rather than broad revenue-raising measures, these early bills were targeted to raise money for specific politically popular military actions, and were designed to raise that money exclusively from the richest Americans.<sup>4</sup> For instance, the first income tax imposed in the United States was enacted in 1861.<sup>5</sup> This law imposed a tax of 3% on all incomes over \$800.<sup>6</sup> As it was originally enacted in order to support the Union efforts in the Civil War, the tax was dramatically curtailed in 1862, and ultimately repealed in 1872.<sup>7</sup> 1894 saw the first peacetime tax in the United States, imposed at the rate of 2% on incomes over \$4000.<sup>8</sup> A tax imposed at that level meant it affected only the top 10% of income earners.<sup>9</sup> The tax was resisted by its opponents, who claimed that, even at the rate of 2%, the imposition of an income tax was a sign of creeping socialism, and the levy was ultimately found unconstitutional in 1895.<sup>10</sup>

In order to permit the imposition of an income tax despite the constitutional prohibition on direct taxes, which prohibition had been

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3. JOHN F. WITTE, *THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX* 67-70 (U. Wis. Press 1985).

4. Tracey M. Roberts, *Brackets: A Historical Perspective*, 108 NW. U. L. REV. 949 (2014).

5. WITTE, *supra* note 3, at 68.

6. *Id.* at 67-70.

7. SIDNEY RATNER, *TAXATION AND DEMOCRACY IN AMERICA* 143 (1967).

8. Erik Jensen, *The Taxing Power, the Sixteenth Amendment and the meaning of Incomes*, 33 ARIZ. ST. L. J. 1057, 1096 (2001) (“The legislation began in the House of Representatives. . . where Democratic Representatives Benton McMillan of Tennessee, chairman of the Ways and Means Subcommittee on Internal Revenue and a longtime proponent of taxation, and the already legendary William Jennings Bryan of Nebraska recommended a two percent tax on incomes of \$4000 or more. That proposal, with changes in detail, in many ways mirrored the Civil War income tax, and it survived the subsequent legislative wrangling as an amendment to a major tariff revision bill.”).

9. *Id.* at 1107. “The Supreme Court struck down the 1894 income tax in the *Income Tax Cases* (Pollack).” *Id.* at 1058.

10. The argument was that the United States Constitution prohibits all “direct” taxes, and Congress could not figure out how to have an income tax that wouldn’t also tax income from property, which was prohibited. For a long discussion of the issues involved in the protest over the 1894 tax, and the ultimate proposal and approval of the 16<sup>th</sup> Amendment. *See id.*

confirmed by the Supreme Court in 1895, the United States ratified the 16th Amendment in 1913, expressly permitting Congress to impose an income tax.<sup>11</sup> The modern income tax was first enacted immediately after the ratification of the 16<sup>th</sup> Amendment in 1913, so 2013 saw the celebration of the centennial of the income tax in the United States. Again, even in its modern form, the income tax was designed as a tax on the wealthy, so most people did not pay the tax when it was first enacted.<sup>12</sup> In 1913, the top tax rate was 7% on incomes above \$500,000.<sup>13</sup> While this threshold is close in absolute numbers to the top tax bracket today, an income of \$500,000 in 1913 would be equivalent to about \$12.4 million in 2017, dramatically higher than the top of the current tax brackets in the United States.<sup>14</sup>

The income tax in the United States expanded during both World War I and World War II, fueled by the argument that justifiable war justified higher tax rates.<sup>15</sup> At first the tax was reduced when the war ended, because the funds needed for the war efforts were no longer needed by a peacetime government. However, post-World War II, the income tax did not really contract all the way back down.<sup>16</sup> During World War I, the top rate had risen to 77% and the income threshold to be in this top bracket had increased to \$1,000,000 (equivalent to \$19.1 million in 2017 dollars).<sup>17</sup> While this might have been politically viable while the United States was fighting in a politically popular war, once the war ended then-Treasury Secretary Andrew Mellon made the argument that such high tax rates had deleterious effects on the economy, thereby reducing the amount of tax revenue the government could collect through the tax.<sup>18</sup> Upon Mellon's recommendation, the top tax rate dropped in the 1920s to 24%.<sup>19</sup> On the brink of World War II, the need

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11. *Id.* at 1108 (“Democratic Representative Cordell Hull of Tennessee introduced income tax legislation in 1907, and the Democratic party called for an income tax amendment in its 1908 platform: [W]e favor an income tax as part of our revenue system, and we urge the submission of a constitutional amendment specifically authorizing congress to levy and collect a tax upon individual and corporate incomes, to the end that wealth may bear its proportionate share of the burdens of the federal government.”).

12. Roberts, *supra* note 4, at 930 (“[T]he initial income tax was low, relatively flat, and applied only to very-high-income taxpayers. . . . The top tax rate of 7% applied to taxable income in excess of \$500,000 (or \$11,765,505 in 2013 dollars).”).

13. *Id.* at 930-31.

14. *Id.* The top income tax bracket in the United States in 2018 began at \$500,000 for single taxpayers and \$600,000 for taxpayers who were married and filed jointly. §1.

15. *Id.* at 949.

16. *Id.* at 930-31.

17. Roberts, *supra* note 4, at 934 (“Congress raised income tax rates sharply to increase revenues for military mobilization.”).

18. This argument became popular over half a century later by the economist Arthur Laffer and his “Laffer Curve”. However, Mellon’s argument had the effect of cutting the highest marginal tax rate by almost 50 points. JOSEPH J. THORNDIKE, *THEIR FAIR SHARE: TAXING THE RICH IN THE AGE OF FDR* 13 (Urban Inst. Press 2013).

19. Roberts, *supra* note 4, at 934.

for revenues to fund the war effort brought tax rates back up to 79% in 1939.<sup>20</sup> That war was extremely politically popular, which allowed politicians to raise the top income tax rate to the almost unfathomable 94% in 1944, on incomes in excess of \$200,000 (about \$3 million in today's dollars).<sup>21</sup> After the end of World War II, tax rates started to drop again - a trend that continued throughout the 1950s.<sup>22</sup> President John F. Kennedy presided over a dramatic cut in the highest marginal tax rates, and then finally President Ronald Reagan and the 1986 Tax Act enacted income tax rates that are more like those we are familiar with today.<sup>23</sup>

Turning to the substance of the tax law itself, rather than considering just the rates, the first codification of the income tax began with a proposed tax code in 1930.<sup>24</sup> The first complete version of an income tax law in the United States was finally enacted in 1939.<sup>25</sup> 1954 saw a reform that included the first major overhaul of the income tax law, and the so-called "54 Act" was the basis of the tax law until the most recent major overhaul, which happened in 1986.<sup>26</sup> Even with the major reforms enacted as part of the 2017 tax bill, the U.S. tax law is still known as the "Tax Reform Act of 1986."<sup>27</sup>

Thinking about tax reform as a political project, many have commented on the ways in which the 2017 tax reform bill looks very different from the work done on the tax reform acts of the past.<sup>28</sup> By contrast with the TCJA, the 1986 Act was a true exercise in bipartisanship.<sup>29</sup> The book "Showdown at Gucci Gulch" by Jeffrey Birnbaum and Alan Murray, provides a front row view of the 86 tax reform experience.<sup>30</sup> The 1986 Act had bipartisan support in both houses of Congress, and Reagan was eager to pass tax reform.<sup>31</sup> The

20. *U.S. Federal Individual Income Tax Rates History, 1962-2013 (Nominal and Inflation-Adjusted Brackets)*, TAX. FOUND., <https://taxfoundation.org/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets/> (last visited July 24, 2019).

21. Roberts, *supra* note 4, at 935.

22. *Id.* at 936 ("By the mid-century mark, tax policy had shifted away from concerns about equal sacrifice, ability to pay, the incidence of the government benefits and burdens, and the importance of reducing federal deficits and eliminating federal debt. Instead policymakers began to use the income tax as an economic tool to spur growth.").

23. *Id.* at 936-938.

24. George K. Yin, *The Joint Committee on Taxation and Codification of the Tax Laws*, 1 (Feb. 26, 2016), <https://uschs.org/wp-content/uploads/2016/02/USCHS-History-Role-Joint-Committee-Taxation-Yin.pdf> ("The staff [of the Joint Committee on Taxation] produced at least three versions of a proposed tax code (in 1930, 1933, and 1938) before a final version was enacted into law in early 1939.").

25. *Id.* Although, as Yin points out, there were early efforts to codify the income tax law in the United States, including an effort in 1873 and another in 1920/1. *Id.* at 10, 13.

26. Roberts, *supra* note 4, at 936-37.

27. *Id.* at 937.

28. Rebecca Kysar, *Tax law and the Eroding Budget Process*, 81 LAW & CONTEMP. PROB. 61 (2018).

29. See JEFFREY BIRNBAUM & ALAN MURRAY, SHOWDOWN AT GUCCI GULCH 3-4 (Random House 1987).

30. *See id.*

31. *Id.* at 21.

central themes of reform in 1986 were attempts to broaden the base (by closing so-called “tax loopholes”) and lowering tax rates to a maximum of 28% on both ordinary income and capital gains.<sup>32</sup> The 86 reform managed to achieve both of those goals, but, perhaps unsurprisingly, the enactment of the law was followed almost immediately by amendments that shrank the base (by introducing new deductions and other tax preferences) and increased the rates (also introducing a distinction between tax rates on ordinary and capital gain income).<sup>33</sup>

Despite the regular (but relatively minor) changes to the tax law over the next twenty years, things stayed relatively stable on the tax front until George W. Bush was elected, riding a promise of significant tax reform.<sup>34</sup> Bush intended to enact significant changes with regard to tax rates and, centrally to his presidential campaign platform, he wanted to oversee the repeal of the estate tax.<sup>35</sup> Despite intense efforts, the Republicans in Washington had insufficient votes to make the changes they wanted permanent.<sup>36</sup> This was the effect of the Byrd Rule, which did not allow the Senate to enact legislation that created deficits beyond ten years without a vote of 60 members of the Senate. As a result, the tax cuts enacted under Bush in 2001 were all scheduled to expire or “sunset” in 2010.<sup>37</sup> This built-in sunset provision led to the next big round of tax reforms, prompted by the imminent expiration of many tax cuts, which would have returned tax rates and provisions to their pre-2001 levels, and would have had the effect of dramatically raising taxes on a significant number of Americans.<sup>38</sup>

The expiration of the Bush-era tax cuts would have returned the estate tax exemption and rate to 1999 levels (the exemption would have fallen to \$675K from \$3.9 million, after a full year of repeal in 2010), and would have

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32. *Id.* at 18.

33. Roberts, *supra* note 4, at 943.

34. Scott Greenberg, *Looking Back at the Bush Tax Cuts, Fifteen Years Later*, TAX FOUND., 1 (June 7, 2016), <https://taxfoundation.org/looking-back-bush-tax-cuts-fifteen-years-later/> (“The Brookings Institution called the surplus of the late 1990s ‘one of the supreme budgetary accomplishments in American history,’ but policymakers were already debating whether to let the surplus continue, whether to use it to fund new spending programs, or whether to use it to fund tax cuts. The Republican nominee for President, George W. Bush, took a clear stance on the issue: the surplus was to be returned to American households in the form of tax relief.”).

35. For a fascinating history of attacks on the federal wealth transfer tax system, see MICHAEL GRAETZ & IAN SHAPIRO, *DEATH BY A THOUSAND CUTS* 10 (Princeton U. Press 2005).

36. Catherine Rampell, *Reader Response: Why Are the Bush tax Cuts Expiring in the First Place?*, TAX C (August 12, 2010), [https://economix.blogs.nytimes.com/2010/08/12/reader-response-why-are-the-bush-tax-cuts-expiring-in-the-first-place/?\\_r=0](https://economix.blogs.nytimes.com/2010/08/12/reader-response-why-are-the-bush-tax-cuts-expiring-in-the-first-place/?_r=0).

37. Greenberg, *supra* note 34, at 2.

38. For a discussion of the expiration of the tax cuts and the effects of a possible expiration, see Emily Horton, *The Legacy of the 2001 and 2003 ‘Bush’ Tax Cuts*, CTR. ON BUDGET AND POL’Y PRIORITIES, 2 (2017), <https://www.cbpp.org/research/federal-tax/the-legacy-of-the-2001-and-2003-bush-tax-cuts>.

raised rates on both ordinary income and capital gain.<sup>39</sup> A compromise was reached in the final days of 2010 to forestall a crisis, but that compromise only provided a two year extension of the existing law. This meant that Washington would shortly have to confront the problem yet again.<sup>40</sup> At the end of 2012 the sun set again on the tax laws, and Washington again faced a crisis. Republicans pushed to make the Bush-era tax cuts permanent, while the Democrats sought to raise taxes, although they too wanted to avoid reverting completely to pre-2001 levels.<sup>41</sup> Again a compromise was reached (actually in the first days of 2013, after the law had officially expired), this time making the tax law changes more permanent.<sup>42</sup> The compromise enacted in 2013 slight raised tax rates on ordinary income and capital gain and set a \$5 million exemption for the estate tax, which was then indexed to inflation.<sup>43</sup> Between 2013 and 2017 there were small changes to elements of the tax law, but nothing that could be called “Fundamental Tax Reform”.

## PART II: HISTORY OF THE TCJA

Tax reform has been an essential part of presidential campaigns in the United States for decades. Politicians regularly establish plans for tax reform as a central part of their platforms for election. The 2016 presidential campaign was no different, with both Donald Trump and Hillary Clinton claiming to be ready to lead on the issue of tax reform, although (perhaps obviously) each candidate approached the problem from a different perspective.<sup>44</sup> Once Trump took office in January 2017, he began his efforts to reform healthcare in earnest. Those efforts were ultimately unsuccessful, as Congress failed to pass a healthcare reform bill in the summer of 2017.<sup>45</sup> With that political failure dogging him, Trump turned his attention to tax reform, and the Republican-controlled House and Senate took up the cause, this time with more success than they had managed on the healthcare front.<sup>46</sup>

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39. *See id.* at 1.

40. Greenberg, *supra* note 34, at 2 (“[W]hen the cuts were finally due to expire in 2010, President Obama extended the cuts for yet another two years, seeking to avert a sudden and dramatic tax increase on American families in the middle of an economic recovery.”).

41. *Id.* (“The ‘fiscal cliff’ deal cemented the vast majority of the 2001 and 2003 Bush tax cuts into permanent law. According to one estimate, 82 percent of the Bush tax cuts were made permanent in 2012, while only 18 percent were allowed to expire.”).

42. *Id.*

43. Horton, *supra* note 38, at 2.

44. For a discussion of the views of all the Democratic and Republican candidates for president in the 2016 election, *see* Jennifer Bird-Pollan, *Why Tax Wealth Transfers?*, 57 B.C. L. REV. 859, 864 (2016).

45. Jennifer Steinhauer, et al., *How the Health Care Bill Failed: GOP Divisions and a Fed-Up President*, N.Y. TIMES (July 18, 2017), <https://www.nytimes.com/2017/07/18/us/politics/trump-health-care-senate-bill.html>.

46. *See infra* Part II.



On September 27, 2017, Republicans from the House, the Senate, and the Trump Administration released a nine-page document called the “Unified Framework for Fixing Our Broken Tax Code.”<sup>47</sup> This document, following on Donald Trump’s principles of tax reform, announced earlier in September, tasked Congress with drafting and passing a significant tax reform bill.<sup>48</sup> The main focus of the framework included tax simplification, tax cuts for the middle class, cutting taxes on business income, and closing “loopholes,”<sup>49</sup> although it also proposed the repeal of the estate tax.<sup>50</sup>

On November 2, 2017, the House of Representatives released its draft of the Tax Cuts and Jobs Act,<sup>51</sup> which proposed cutting the number of individual income tax brackets from seven to four,<sup>52</sup> significantly increasing the size of the standard deduction,<sup>53</sup> capping the home mortgage interest deduction at \$500,000 of principal,<sup>54</sup> and eliminating the deduction for state and local taxes, with the exception of a deduction for property taxes, capped at \$10,000.<sup>55</sup> Some of the other significant changes in the House version of the bill were the proposal to cut the corporate tax rate to 20% and capping pass-through business income tax rates at 25%.<sup>56</sup> The House bill would have also fully eliminated the federal estate tax.<sup>57</sup>

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47. *Unified Framework For Fixing Our Broken Tax Code*, TREAS. (Sept. 27, 2017), <https://www.treasury.gov/press-center/press-releases/documents/tax-framework.pdf>.

48. *Id.* at 3. (“This unified framework serves as a template for the tax-writing committees that will develop legislation through a transparent and inclusive committee process.”).

49. *Id.* (The bullet point list indicating the major components of the new bill is as follows: “– Tax relief for middle-class families; – The simplicity of ‘postcard’ tax filing for the vast majority of Americans; – Tax relief for businesses, especially small businesses; – Ending incentives to ship jobs, capital, and tax revenue overseas; – Broadening the tax base and providing greater fairness for all Americans by closing special interest tax breaks and loopholes.”).

50. *Id.* at 6. (“The framework repeals the death tax and the generation-skipping transfer tax.”); see also GRAETZ & SHAPIRO, *supra* note 35. Note, there is no federal tax formally identified as the “death tax”. One can only assume that this is a reference to the federal estate tax codified in USC §2001. The reference to death tax is a political move that has been long supported by the anti-tax activist Grover Norquist and others.

51. H.R. 1, 115th Cong. (1st Sess. 2017), [https://republicans-waysandmeansforms.house.gov/uploadedfiles/bill\\_text.pdf](https://republicans-waysandmeansforms.house.gov/uploadedfiles/bill_text.pdf).

52. *Id.* at 7. The proposed bill introduced tax brackets at rates of 12%, 25%, 35%, and 39.6%.

53. *Id.* at 21. The proposed bill would have increased the standard deduction to \$24,400 for a joint return, and half that amount for all other categories of returns.

54. *Id.* at 99. Deductible home mortgage interest under the proposed bill would have been capped, such that interest on only the first \$500,000 of mortgage principal would have been deductible for most taxpayers (half that amount, in the case of a taxpayer filing as married filing separately).

55. *Id.* at 104. In practice, the proposed bill eliminated the deduction for all taxes not incurred in a trade or business, but then allowed up to \$10,000 of deduction for the payment of property taxes.

56. H.R. 1 at 186. The proposed bill reduced the corporate tax rate to 20%, while imposing tax at rate of 25% on Personal Service Corporations.

57. *Id.* at 168. The proposed bill would have doubled the exemption amount against the estate tax imposed on estates of individuals who died from 2018 through 2023, and then would have fully eliminated the estate tax beginning in 2024.

The Senate version of the bill, released on November 10, 2017,<sup>58</sup> maintained the seven individual income tax brackets,<sup>59</sup> while lowering the rates slightly<sup>60</sup> and significantly increasing the standard deduction.<sup>61</sup> Among other things, the Senate proposal fully eliminated the deduction for state and local taxes,<sup>62</sup> while fully maintaining the deduction for home mortgage interest.<sup>63</sup> In the business tax arena, the Senate version of the bill lowered the corporate tax rate to 20%,<sup>64</sup> and established a 17.4% deduction of pass-through business income.<sup>65</sup> Although the Senate version left the estate tax in place, it did propose doubling the estate tax exemption amount to \$11.2 million per taxpayer.<sup>66</sup>

After passage in both houses of Congress, the bill conference began in early December 2017.<sup>67</sup> On Friday, December 15, the bill passed out of conference, in amended form.<sup>68</sup> The final version of the bill maintained the seven individual income tax brackets, while lowering rates and expanding brackets slightly.<sup>69</sup> The bill also increased the standard deduction significantly while capping the state and local tax deduction at \$10,000 per tax return (whether single or married), and capping the home mortgage interest deduction at a principal amount of \$750,000.<sup>70</sup> The final version of

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58. The Senate Finance Committee draft bill, released by Senator Orrin Hatch, (Nov. 10, 2017), <https://www.finance.senate.gov/imo/media/doc/11.9.17%20Chairman's%20Mark.pdf>.

59. *Id.* at 8. While the Senate version of the bill lowered the rates imposed at the brackets slightly, it did keep the number of the brackets at seven.

60. *Id.* The seven brackets in the proposed bill went from the 2017 rates of 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%, to proposed 2018 rates of 10%, 12%, 22.5%, 25%, 32.5%, 35%, and 38.5%.

61. *Id.* at 11. The proposed Senate bill would have increased the standard deduction to \$24,000 for taxpayers who were married and filing jointly. Head of household taxpayers would have been eligible for an \$18,000 standard deduction, and all other taxpayers would have qualified for a \$12,000 standard deduction under the proposal.

62. *Id.* at 23. While the original House proposal left in place a deduction for \$10,000 of property taxes, the Senate proposal would have fully repealed the deduction for the payment of any taxes not paid or accrued in a trade or business.

63. *Supra* note 58, at 25. While the Senate bill did the leave the deduction for interest on home mortgage acquisition indebtedness in place, it would have repealed the deduction for home equity indebtedness, which had been allowed for interest on mortgage amounts up to \$100,000.

64. *Id.* at 55.

65. *Id.* at 14. The introduction of the pass-through deduction in the Senate bill is the first time the idea appeared, before it was ultimately adopted as part of the final statute.

66. *Id.* at 38. This increase in the proposed bill reflected a doubling of the amount permitted to be exempted from tax under the 2017 law.

67. Alan Rappeport, *Republicans Move to Resolve Tax Bill Differences as Cost Concerns Loom*, N.Y. TIMES (Dec. 6, 2017), <https://www.nytimes.com/2017/12/06/us/politics/republicans-move-to-resolve-tax-bill-differences-as-cost-concerns-loom.html>.

68. Jared Walczak et al., *Details of the Conference Report for the Tax Cuts and Jobs Act*, TAX FOUND. (Dec. 15, 2017), <https://taxfoundation.org/conference-report-tax-cuts-and-jobs-act/> (“On Friday, House and Senate conferees signed off on a conference report resolving the differences between the versions of the Tax Cuts and Jobs Act that passed each chamber.”).

69. Tax Cuts and Job Acts, Pub. L. No. 11597, 131 Stat. 2054 § 11001 (LexisNexis 2019), <https://www.congress.gov/115/plaws/pub197/PLAW-115pub197.pdf>.

70. *Id.* § 11043.

the bill set the corporate tax rate at 21%,<sup>71</sup> and offered a 20% deduction for business pass-through income.<sup>72</sup> With regard to wealth transfer taxes, the bill set the exemption for the estate tax at \$11.2 million per taxpayer, double the previous amount.<sup>73</sup> Finally, the bill eliminated the penalty for failing to have health insurance, effectively eliminating the individual mandate component of the ACA.<sup>74</sup> Donald Trump signed the final version of the bill into law on December 22, 2017, marking the first major piece of legislation of his administration.<sup>75</sup>

While passage of the bill was widely touted as a success for Republican lawmakers, most provisions of the bill are scheduled to sunset at the end of 2025, since budget constraints prevented many of the provisions from being enacted permanently.<sup>76</sup> Republicans hope to have sufficient votes in Congress before the expiration of the cuts in order to vote to make them permanent.<sup>77</sup>

### PART III: ELEMENTS OF THE TCJA

#### A. *Permanent vs. Temporary Changes to the Tax Law*

While the TCJA represents a major overhaul to the United States tax law, the majority of the provisions of the bill are enacted with a sunset provision built in.<sup>78</sup> All but two of the individual income tax provisions are scheduled

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71. *Id.* § 13001.

72. *Id.* § 11011.

73. *Id.* § 11061.

74. *Id.* § 11081.

75. Howard Gleckman, *How the Tax Cuts and Jobs Act Evolved*, TAX POL'Y CTR. (Dec. 28, 2017), <https://www.taxpolicycenter.org/taxvox/how-tax-cuts-and-jobs-act-evolved> (“The Tax Cuts and Jobs Act that Congress passed on Dec. 22 was quite different from the tax cuts proposed by the Trump Administration last April and the Unified Framework that the White House and top congressional Republicans agreed to in September. While the overall direction did not change – the plan started and ended primarily as a big tax cut for businesses – it underwent two significant alterations: it got much smaller and it became far less regressive.”).

76. Jeanne Sahadi, *Enjoy Your Tax Cuts While They Last*, CNN MONEY (Dec. 20, 2017), <https://money.cnn.com/2017/12/20/pf/taxes/tax-cuts-temporary/index.html> (“Republicans made individual tax cuts temporary so they could meet budget rules that let them pass their tax overhaul with no Democratic votes.”); see also Amir El-Sibaie, *A Look Ahead at Expiring Tax Provisions*, TAX FOUND. (Jan. 18, 2018), <https://taxfoundation.org/look-ahead-expiring-tax-provisions/> (“December 31<sup>st</sup>, 2025, will be a significant day for most taxpayers. Twenty-three provisions from the Tax Cuts and Jobs Act directly relating to individual income taxes will expires, meaning most taxpayers will see a tax hike unless some or all provisions are extended.”).

77. Sahadi, *supra* note 76 (“Don’t worry, [Republicans] say. A future Congress won’t let middle class tax cuts expire. Recent precedents – like the oft-extended Bush tax cuts – suggest they may be right. Still, there’s zero guarantee of that. After all, a lot can change over eight years.”).

78. See *List of Expiring Tax Provisions*, (Jan. 9, 2018), <https://www.jct.gov/publications.html?func=startdown&id=5057> (Twenty-five provisions enacted as part of the TCJA are scheduled to expire. Twenty-three of them will expire at the end of 2025, while the remaining two will expire at the end of 2026).

to sunset at the end of 2025, unless they are extended.<sup>79</sup> The two individual income tax provisions that do not have sunsets are the change to the inflation index and the repeal of the penalty for the failing to have health insurance, which most commentators view as the practical repeal of the individual mandate.<sup>80</sup> By contrast, the business tax provisions have been adopted without a sunset.<sup>81</sup> This makes estimates of the distributional effects of the bill difficult to make with confidence, since the effects will change based on whether or not the provisions are extended.<sup>82</sup>

The first permanent change to the individual income tax law enacted under the TCJA is a shift to the use of a chained CPI (consumer price index) measure of inflation to adjust annually the numbers that are built in to the tax law.<sup>83</sup> The tax law had historically used the traditional CPI measure of inflation.<sup>84</sup> Traditional CPI compares the price of items that people buy regularly before and after the period in question to measure the change in cost of living over time.<sup>85</sup> This measure has historically been criticized, because it fails to account for the fact that, when certain items increase in price,

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79. *Id.* These include the modification of individual income tax rates, and the special rules for unearned income of children; the changes to the child tax credit; the changes to the Alternative Minimum Tax; the increase in the standard deduction; the suspension of the miscellaneous itemized deductions; the suspension of the limitation on itemized deductions; the exemption for student loan discharges on account of death or disability; the treatment of certain individuals performing services on the Sinai Peninsula of Egypt; the suspension of the exclusion for the reimbursement of bicycle commuting; the suspension of the exclusion for moving expense reimbursement; the suspension of the deduction for personal exemptions; the limitation on the deduction for qualified residence and home equity interest; the limitation on the deduction for state and local taxes; the changes to the personal casualty loss deductions; the modifications to the rules relating to wagering losses; the increase percentage limitation on cash contributions to public charities; the qualified business income deduction (§199A); the suspension of the deduction for moving expenses; the deductibility of employer *de minimis* meals and related eating facilities and meals for the convenience of the employer; the transfer of excess pension assets to retiree health and life insurance accounts; the limitation on excess business losses of noncorporate taxpayers; changes to ABLÉ accounts; and the increase in the estate and gift tax exemption.

80. David Blumenthal, *How the New U.S. Tax Plan Will Affect Health Care*, HARV. BUS. REV. (Dec. 19, 2017), <https://hbr.org/2017/12/how-the-new-u-s-tax-plan-will-affect-health-care> (“According to the Congressional Budget Office, the repeal of the individual mandate penalties could result in as many as 13 million fewer Americans having health insurance.”).

81. William G. Gale, *(Not So) Happy Birthday to the Tax Cuts and Jobs Act*, TAX POL’Y CTR. (Dec. 19, 2018), <https://www.taxpolicycenter.org/taxvox/not-so-happy-birthday-tax-cuts-and-jobs-act> (The corporate tax rate reduction and the international tax provisions enacted as part of the TCJA are not scheduled to expire. “Most of the corporate tax provisions are permanent, while most individual income tax and estate tax provisions (except for health insurance provision mentioned above) expire after 2025.”).

82. *Id.*

83. Steve Wamhoff, *Chained CPI Would Raise Everyone’s Personal Income Taxes in the Future, Would Hurt the Poor Right Away*, INST. ON TAX’N AND ECON. POL’Y (Nov. 30, 2017), <https://itep.org/chained-cpi-would-raise-everyones-personal-income-taxes-in-the-future-would-hurt-the-poor-right-away/> (“The only change to personal income taxes for families and individuals still in effect in 2027 would be the less generous inflation adjustment based on the consumer price index (chained CPI).”).

84. Rob McClelland, *Differences Between the Traditional CPI and the Chained CPI*, CONG. BUDGET OFF. (Apr. 19, 2013), <https://www.cbo.gov/publication/44088>.

85. *Id.*

consumers will often substitute other items whose prices have not increased, or the consumers will simply purchase fewer goods.<sup>86</sup> This ‘substitution bias’ can reduce the actual cost of living increase caused by the increase in the price of goods. Some commentators argue that changing from using traditional CPI to using chained CPI allows the inflation index to more accurately track changes in the cost of living, since chained CPI accounts for substitution bias.<sup>87</sup> In fact, a switch to chained CPI was considered under both the George W. Bush and Obama presidencies.<sup>88</sup> However, because traditional CPI tracks cost of living changes as higher than under chained CPI, using chained CPI will have the effect of raising taxes more quickly than they would have been raised using traditional CPI.<sup>89</sup> For instance, under a traditional CPI measure, the upper limit of a tax bracket would increase more quickly than it would under the chained CPI measure.<sup>90</sup> The result is that, using chained CPI, more of a taxpayer’s income will move into the higher tax bracket more quickly, which means the taxpayer will pay more tax on the same amount of income.<sup>91</sup> In fact, the Joint Committee on Tax estimates that the switch from traditional CPI to chained CPI will net the government \$134 billion in revenue over the next ten years.<sup>92</sup>

The other provision enacted regarding individual income tax law that passed without a sunset date is the repeal of the tax penalty for failing to have adequate health insurance.<sup>93</sup> While the Republicans failed to pass a full repeal

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86. *Id.* (“The traditional versions of the CPI are based on spending patterns from a point in the past, and so do not fully incorporate the effects of consumers’ substitution between various goods and services when their relative prices change. As a result, those traditional versions of the CPI overstate the amount by which consumers’ well being declines when prices rise and understate the benefit of reductions in prices. Therefore, the traditional versions tend to grow faster than the cost of living does.”).

87. *Id.* (“Although many analysts consider the chained CPI to be a more accurate measure of the cost of living than the traditional CPI, using it for indexing could have disadvantages.”).

88. See, e.g., Kathy Ruffing et al., *Chained CPI Can Be Part of a Balanced Deficit-Reduction Package, Under Certain Conditions*, CTR. ON BUDGET AND POL’Y PRIORITIES (Feb. 22, 2012), <https://www.cbpp.org/research/chained-cpi-can-be-part-of-a-balanced-deficit-reduction-package-under-certain-conditions> (“A proposal included in several deficit-reduction packages – those from fiscal commission co-chairs Erskine Bowles and Alan Simpson, the Domenici-Rivlin panel, and the Senate ‘Gang of Six’ – would shift from the regular or official Consumer Price Index (CPI) to the ‘superlative’ or ‘chained’ CPI when indexing various federal benefit and tax code provisions. This proposal would gradually trim the growth of benefit programs and boost future tax revenues.”).

89. Wamhoff, *supra* note 83.

90. *Id.*

91. *Id.* (“Chained CPI would gradually push taxpayers into higher income tax brackets and make the standard deduction, the Earned Income Tax Credit, and several other tax breaks less generous over time. This change would, on its own, increase taxes on all income groups in years after 2025 (including 2027).”).

92. *Estimated Budget Effects of the Conference Agreement for H.R. 1 the ‘Tax Cuts and Jobs Act*, JOINT COMMITTEE ON TAX’N (Dec. 18, 2017), <https://www.jct.gov/publications.html?func=startdown&id=5053> [hereinafter *JCT Estimated Budget Effects*].

93. Dylan Scott, *A Requiem for the Individual Mandate*, VOX.COM (Apr. 13, 2018), <https://www.vox.com/policy-and-politics/2018/4/13/17226566/obamacare-penalty-2018-individual-mandate-still-in-effect>.

of the ACA earlier in 2017, most commentators see the repeal of the penalty for lack of health insurance as the effective repeal of the individual mandate component of the ACA.<sup>94</sup> The economic cost of the repeal of the penalty is not high, but the repeal is likely to result in many fewer taxpayers having health insurance coverage.

All remaining individual income tax changes (other than the repeal of the individual mandate provision and the move to chained CPI) coming out of the TCJA are set to sunset at the end of 2025.<sup>95</sup> By contrast, the changes regarding corporate taxes and the international tax changes have all been enacted without a sunset provision. Importantly, however, one of the most significant of the business tax changes, the deduction for business income earned through a pass-through entity, and discussed below, is practically speaking an individual tax provision, and therefore also scheduled to expire at the end of 2025.<sup>96</sup> This anticipated expiration creates interesting problems for taxpayers making business decisions in the face of uncertainty about the future of the tax law in the United States.

## B. INDIVIDUAL INCOME TAX PROVISIONS

### 1. Tax Rates

The TCJA reduced individual income tax rates, and increased the size of most tax brackets, so that taxpayers at most income levels experienced a tax cut in the short term.<sup>97</sup> Notably, however, certain single taxpayers and taxpayers who file as head of household and have around \$200,000 in taxable income saw a slight *increase* in their tax liabilities as a result of the changes to the brackets.<sup>98</sup>

#### 2018 TAX RATES AND BRACKETS UNDER PREVIOUS LAW

Rate	Single	Joint	Head of Household
10%	\$0 - 9,525	\$0-19,050	\$0 – 13,600

94. See Matthew Fiedler, *How Did the ACA's Individual Mandate Affect Insurance Coverage*, CTR. FOR HEALTH POL'Y AT BROOKINGS (May 2018), <https://www.brookings.edu/wp-content/uploads/2018/05/coverageeffectsofmandate2018.pdf>.

95. *Supra* note 78.

96. *Id.*

97. See Scott Eastman, *The TCJA Lowered Taxes for Individuals Throughout Income Groups*, TAX FOUND. (Mar. 26, 2019), <https://taxfoundation.org/tcja-lowered-taxes-individuals-throughout-income-groups/>.

98. Under the previous tax law, a taxpayer filing singly in 2018 and earning \$205,000 of taxable income would have found her last dollars of income taxed at the marginal tax rate of 33%. Under the TCJA, the same taxpayer would fall in the 35% marginal tax bracket, a rate increase of 2% on her last dollars of income.

15%	\$9,525 - 38,700	\$19,050 - 77,400	\$13,600 - 51,800
25%	\$38,700 - 93,700	\$77,400- 156,150	\$51,800- 133,850
28%	\$93,700 -195,450	\$156,150-237,950	\$133,850-216,700
33%	\$195,450 -424,950	\$237,950- 424,950	\$216,700- 424,950
35%	\$424,950- 426,700	\$424,950- 480,050	\$424,950- 453,350
39.6%	\$426,700 and up	\$480,050 and up	\$453,350 and up

#### 2018 TAX RATES AND BRACKETS UNDER THE TCJA

Rate	Single	Joint	Head of Household
10%	\$0 - 9,525	\$0-19,050	\$0 - 13,600
12%	\$9,525 - 38,700	\$19,050 - 77,400	\$13,600 - 51,800
22%	\$38,700 - \$82,500	\$77,400 - 165,000	\$51,800 - 82,500
24%	\$82,500 - 157,500	\$165,000 - 315,000	\$82,500 - 157,500
32%	\$157,500 - 200,000	\$315,000 - 400,000	\$157,500 - 200,000
35%	\$200,000 - 500,000	\$400,000 - 600,000	\$200,000 - 500,000
37%	\$500,000 and up	\$600,000 and up	\$500,000 and up

## 2. Standard Deduction/Personal Exemptions

One major change in the TCJA was the significant increase in the size of the standard deduction.<sup>99</sup> The standard deduction for single taxpayers increased under the law from \$6,500 to \$12,000.<sup>100</sup> For taxpayers who file jointly it increased from \$13,000 to \$24,000.<sup>101</sup> Taxpayers who file as head of household received an increase in the standard deduction from \$13,000 to \$18,000.<sup>102</sup> At the same time that Congress increased the standard deduction,

99. I.R.C. § 63 (West Supp. 2018).

100. *Id.*

101. *Id.*

102. *Id.*

the TCJA also eliminated personal exemptions, which, under previous law, had exempted \$4,500 of income for each taxpayer and dependent claimed on a return.<sup>103</sup> Under previous law, approximately 30% of taxpayers elected to itemize their deductions annually on their tax returns.<sup>104</sup> Given the increase in the size of the standard deduction, commentators estimate that only about 10% of taxpayers will elect to itemize their deductions under the new rules.<sup>105</sup> This is widely viewed as a simplifying change, since non-itemizers generally have fewer record-keeping responsibilities and less complicated tax returns.<sup>106</sup> However, the elimination of the personal exemption at the same time that the standard deduction is increased will likely result in a wash for most taxpayers, affecting families differently based only on the number of dependents they have.<sup>107</sup> Larger families will now likely have slightly more taxable income, while families with fewer dependents will likely have slightly less taxable income than they did before enactment of the TCJA.<sup>108</sup>

### 3. *State and Local Tax (SALT) Deduction*

The TCJA capped the total amount of state and local taxes deductible on a tax return at \$10,000.<sup>109</sup> This \$10,000 cap applies to both income and property taxes, and applies per return, whether the return is of a married couple filing jointly, or a single taxpayer.<sup>110</sup> This cap combines with the higher standard deduction to cause the significant reduction in the number of

103. § 151 (authorizing personal exemptions). The TCJA added subsection §151(d)(5), which reads “In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026, (A) the term “exemption amount” means zero.”

104. Tax Policy Center, *Tax Policy Center Briefing Book: Key Elements of the U.S. Tax System*, TAX POL’Y CTR. (last visited Jun. 26, 2019), <https://www.taxpolicycenter.org/briefing-book/what-are-itemized-deductions-and-who-claims-them>.

105. *Id.* (“The 2017 Tax Cuts and Jobs Act will significantly reduce the number of taxpayers who claim itemized deductions, because it substantially increased the standard deduction while also restricting or eliminating some itemized deductions in 2018 through 2025. The Urban-Brookings Tax Policy Center estimates that the percentage of all households that itemize (including nonfilers) will shrink from 26 percent in 2017 to about 10 percent in 2018.”).

106. See Staff of the Joint Committee on Taxation, *Eliminate Itemized Deductions*, CONG. BUDGET OFF. (Dec. 13, 2018), <https://www.cbo.gov/budget-options/2018/54791> (“[E]liminating itemized deductions would simplify the tax code. Taxpayers would no longer have to keep records of their deductible expenses or enumerate them on the tax form.”).

107. Jerry Zremski, *GOP Tax Bill Penalizes Married Couples and Larger Families*, THE BUFF. NEWS (December 17, 2017), <https://buffalonews.com/2017/12/16/gop-tax-bill-penalizes-married-couples-and-larger-families/>.

108. *Id.* (“The loss of the personal exemption will hit families with children especially hard, meaning those with more than three children could end up paying higher taxes.”).

109. §164(b)(6) (“In the case of an individual and a taxable year beginning after December 31, 2017, and before January 1, 2026. . . (B) the aggregate amount of taxes taken into account under paragraphs (1), (2), and (3) of subsection (a) and paragraph (5) of this subsection for any taxable year shall not exceed \$10,000 (\$5,000 in the case of a married individual filing a separate return).”).

110. See § 164(a) (“[T]he following taxes shall be allowed as a deduction for the taxable year within which paid or accrued: (1) State and local. . . taxes. (2) State and local personal property taxes.”).



taxpayers who itemize their deductions under the TCJA.<sup>111</sup> Most taxpayers, especially those in high tax states, those who file jointly, and those who own their own homes, pay significantly more than \$10,000 in state and local taxes.<sup>112</sup> Some single filers may still choose to itemize, as the combination of \$10,000 in deductible state and local taxes and their deductible home mortgage interest may exceed their new \$12,000 standard deduction.<sup>113</sup>

State governments of higher tax states responded quickly to the significant reduction in the deductibility of state and local income taxes.<sup>114</sup> Commentators have suggested a variety of possible strategies for maintaining the deductibility of amounts contributed to state and local governments.<sup>115</sup> Both New York and California explored the possibility of allowing contributions to certain charitable organizations to qualify as the payment of state income taxes, since charitable contributions remain fully deductible under the TCJA.<sup>116</sup> It remains unclear how successful such strategies will be in the face of courts that may recharacterize the payments as nondeductible state tax payments.

#### 4. Home Mortgage Interest Deduction

Before the TCJA, home mortgage interest incurred on the first \$1,000,000 of principal indebtedness, plus interest incurred on the first \$100,000 of home equity indebtedness was deductible.<sup>117</sup> After much deliberation and debate, the home mortgage interest deduction provision remained in the TCJA, but with important changes. First, interest on newly incurred home equity indebtedness is no longer deductible, unless the borrowed funds are used to purchase or improve the home.<sup>118</sup> If the home equity loan funds are used to improve the home, then the debt is characterized as acquisition indebtedness, which had been true under previous law as

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111. *Eliminate Itemized Deductions*, *supra* note 106 (explaining that the current limits on deductions are worse for itemization than the changes set to take place in 2026).

112. Gary Strauss, *The New Tax Law and You*, AARP (Mar. 7, 2018), <https://www.aarp.org/money/taxes/info-2018/new-tax-law.html> (giving examples of people who pay more than \$10,000 in state and local taxes).

113. *Id.* (explaining an example of a midwestern widow who itemized deductions for 2017).

114. *See, e.g.*, Frank Sammartino, *How New York State Responded to The SALT Deduction Limit*, TAX POL'Y CTR.: TAXVOX (May 14, 2018), <https://www.taxpolicycenter.org/taxvox/how-new-york-state-responded-salt-deduction-limit> (explaining that New York passed legislation in order to give residents relief from the federal SALT deduction cap).

115. David Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439, 1477 (2019).

116. *Id.* at 1479-80.

117. Kelly Phillips Erb, *IRS Issues Guidance For Deducting Home Equity Loan Interest Under the New Tax Law*, FORBES (Feb. 22, 2018, 01:31 PM), <https://www.forbes.com/sites/kellyphillipserb/2018/02/22/irs-issues-guidance-for-deducting-home-equity-loan-interest-under-the-new-tax-law/#29bbf30d6453>.

118. I.R.S. Pub. 936, 1 (Apr. 30, 2019).

well.<sup>119</sup> In addition, for the purchase of new homes, the cap on the principal amount of indebtedness that generates deductible interest is \$750,000.<sup>120</sup> Most analysts believe that this new lower cap will have some effect on house prices at the higher end of the housing market, as the non-deductibility of interest in excess of \$750,000 will likely affect how much buyers are willing to pay for their houses, at least at the margin.<sup>121</sup> However, this modest reduction in the cap will not have the sort of serious negative effects that commentators worried would result from an elimination of the home mortgage interest reduction, or a cap set at half of its previous cap.

### 5. *Other Individual Income Tax Changes*

Several other individual income tax deductions were repealed under the TCJA.<sup>122</sup> In the above the line deduction category, the deductions available for moving expenses<sup>123</sup> and for the payment of alimony<sup>124</sup> have both been repealed. Miscellaneous deductions have been suspended under the TCJA.<sup>125</sup> The Child Tax Credit amount has been increased from \$1,000 per child to \$2,000 per child, with \$1,400 of the credit amount eligible to be refunded.<sup>126</sup> The phase-out levels for this new larger credit have also been significantly increased, so many more taxpayers will now be eligible for the credit.<sup>127</sup> The Alternative Minimum Tax exemption level has been raised to \$1,000,000 for a married couple filing jointly, dramatically reducing the number of taxpayers

119. *Id.* at 2.

120. § 163(h) (providing the deduction for interest on acquisition indebtedness); *but see* § 163(h)(3)(F) (“(i) In the case of taxable years beginning after December 31, 2017, and before January 1, 2026 – (I) Disallowance of home equity indebtedness interest: Subparagraph A(ii) shall not apply. (II) Limitation on acquisition indebtedness: Subparagraph (B)(ii) shall be applied by substitution “\$750,000” (\$375,000” for “\$1,000,000 (\$500,000”).”). However, this provision only applies to indebtedness incurred after December 15, 2017. *See* § 163(h)(3)(F)(III).

121. *See* Samantha Sharf, *How the New Tax Law Will Impact Your Housing Costs*, FORBES (Jan. 9, 2018, 10:04 AM), <https://www.forbes.com/sites/samanthasharf/2018/01/09/what-in-the-final-tax-bill-could-impact-your-housing-costs/#4e89d64b2c08>.

122. *2018 Tax Cuts & Jobs Act Overview*, SMITH & HOWARD (last visited July 5, 2019), <https://www.smith-howard.com/2018-tax-cuts-jobs-act-overview/> (giving an overview of how the TCJA changed individual taxes).

123. Donaldson, *supra* note 1, at 10.

124. Donaldson, *supra* note 1, at 9. The tax treatment of alimony was reversed under the TCJA as compared to prior law. Historically the payment of alimony was deductible to the payor, but the receipt of alimony was includible as gross income to the payee. *Id.* Both of those provisions were repealed under the TCJA, so that the deduction for paying alimony is denied to the payor, and the payee is no longer required to report the receipt of alimony as an item of gross income. *Id.*

125. Donaldson, *supra* note 1, at 10.

126. § 24, *invalidated by* Texas v. United States, 340 F.Supp.3d 579 (2018); Donaldson, *supra* note 1 at 5.

127. Erica York, *Family Provisions in the New Tax Code*, TAX FOUND., (Oct. 31, 2018), <https://taxfoundation.org/family-provisions-in-the-new-tax-code/> (“The Joint Committee on Taxation estimates that in 2018, the child tax credit will reduce federal revenues by \$103.8 billion, which is significantly larger than the pre-TCJA estimate of \$54.2 billion for 2018.”).

who will be subject to the tax.<sup>128</sup> Finally, 529 plans, historically used by taxpayers as a tax-preferred way of saving for college, may now be used to pay for K-12 education expenses as well, making tax-preferred dollars available for taxpayers' private school costs.<sup>129</sup>

## C. BUSINESS TAX PROVISIONS

### 1. Corporate Tax Reform

After significant discussion of radical reform of the corporate tax regime, the TCJA actually changes very little about the corporate income tax law. The rate reduction from 35% to 21% is the most significant change to the corporate tax law under the TCJA.<sup>130</sup> For most corporations, the 35% rate was, as a practical matter, a flat rate, but the TCJA made the 21% flat for all corporate income taxpayers.<sup>131</sup> It is unclear what effect this rate reduction will have on choice of entity for domestic businesses, in particular when combined with the deduction for business income of pass-through entities, discussed below. However, some commentators believe the reduction in the nominal rate makes the United States corporate tax law more competitive in the international arena, since it reduces the statutory corporate income tax rate from one of the highest, to one of the lowest.<sup>132</sup>

### 2. Expensing and Depreciation

Another significant business tax provision enacted under the TCJA is the implementation of a 100% bonus depreciation allowance.<sup>133</sup> This is not the first time Congress has enacted such a provision. 100% bonus depreciation was part of the 2010 tax reform bill as well.<sup>134</sup> Bonus depreciation allows business taxpayers to take as a deduction a prescribed amount of the purchase price of a newly purchased asset.<sup>135</sup> 100% bonus depreciation allows a

128. Donaldson, *supra* note 1, at 42 (“The House Bill called for complete repeal of the individual AMT to accompany repeal of the corporate AMT, but the Senate would not have it. Instead, the final Act temporarily increases both the exemption amount and the exemption amount’s phaseout threshold. . .”).

129. Donaldson, *supra* note 1, at 6 (“The Act now defines ‘qualified higher education expenses’ to include tuition expenses at ‘an elementary or secondary public, private, or religious school’ and even expenses for materials and therapies in connection with homeschooling.”).

130. § 11; Donaldson *supra* note 1, at 12.

131. Donaldson, *supra* note 1, at 12.

132. Robert Bellafiore, *The Lowered Corporate Income Tax Rate Makes the U.S. More Competitive Abroad*, TAX FOUND. (May 2, 2019), <https://taxfoundation.org/lower-us-corporate-income-tax-rate-competitive/>.

133. § 168(k); Donaldson, *supra* note 1, at 25.

134. I.R.S. Pub. 946, 27 (Apr. 6, 2011).

135. *Cost Segregation Audit Techniques Guide – Chapter 6.8 – Bonus Depreciation Considerations*, IRS (last updated Feb. 28, 2019), <https://www.irs.gov/businesses/cost-segregation-audit-techniques-guide-chapter-6-8-bonus-depreciation-considerations#1>.

taxpayer to deduct 100% of the purchase price of all newly acquired assets both purchased and placed into service between September 28, 2017 and December 31, 2022, making the TCJA, at least in part, a retroactive tax bill.<sup>136</sup> For tax years beginning in 2023 and beyond, the bonus depreciation provision phases out, until the bonus depreciation amount reaches 0% in 2028.<sup>137</sup> Bonus depreciation and other provisions like it are meant to incentivize spending by businesses, as part of a stimulus plan to boost the economy.<sup>138</sup>

At the same time as the dramatic increase in the bonus depreciation percentage, the TCJA raised the cap on section 179 expensing from \$500,000 to \$1,000,000.<sup>139</sup> Previous years had seen the section 179 expensing amount fall to as low as \$25,000.<sup>140</sup> Like bonus depreciation, section 179 expensing allows taxpayers the benefit of an immediate deduction for the purchase of newly acquired assets.<sup>141</sup> Rather than structuring this as additional depreciation amounts, section 179 treats these amounts as expenses rather than capital expenditures, which allows the amounts to be immediately deducted.<sup>142</sup> Because bonus depreciation is currently set at 100%, most businesses have no need for an increased section 179 deduction in the short term.<sup>143</sup> However, if Congress renews the increased section 179 cap beyond the phase out of the 100% bonus depreciation provision, then section 179 may again become relevant.<sup>144</sup>

### 3. *Pass-Through Tax Provisions*

One of the most talked about provisions of the TCJA is the new deduction for business income earned by a pass-through entity. Unlike corporations, whose income is taxed once at the entity level and then a second time when it is distributed to owners in the form of dividends, pass-through entities (such as partnerships, most LLCs, and other entities that elect pass-through treatment under the tax law) are only subject to one layer of income tax, so

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136. See § 168(k). The bill was not enacted until mid-December 2017 but allowed for the expensing of amounts spent up to two months earlier on capital expenditures. It is hard to make the claim that the law incentivizes an activity, if that activity occurred two months before the law was enacted.

137. § 168(k).

138. Scott A. Hodge, *Testimony: The Positive Economic Growth Effects of the Tax Cuts and Jobs Act*, TAX FOUND. (Sept. 6, 2018), <https://taxfoundation.org/tcja-economic-growth-effects-testimony/> (“[T]he provision will pull some investments forward, leading to faster growth in earlier years that slows back down as the provision expires in later years.”).

139. § 179; Donaldson, *supra* note 1, at 24, 25.

140. See § 179 (2014), amended by § 179 (2017).

141. § 179.

142. *Id.*

143. *Who Needs Sec. 179 expensing when 100% Bonus Depreciation is Available?*, THOMSON REUTERS TAX & ACCT. (Oct. 5, 2018), <https://tax.thomsonreuters.com/news/who-needs-sec-179-expensing-when-100-bonus-depreciation-is-available/>.

144. *Id.*

all income, deductions, and credits are passed through to the entity's owner and taxed at that individual's income tax rate.<sup>145</sup> Earlier Republican proposals had suggested reducing the tax rate on pass-through business income, but, rather than distinguishing between the rates imposed on pass-through income and other income, the TCJA ultimately instituted a deduction of 20% of the business income a taxpayer earns from a pass-through entity.<sup>146</sup>

This new pass-through deduction is subject to several limitations. First, the deduction is not available to service providers (such as lawyers, doctors, and accountants, however it remains available to architects and engineers, who appear to have had better lobbyists), unless the service provider earns less than \$315,000 if filing jointly, \$157,500 if filing single.<sup>147</sup> If the taxpayer is below the income threshold, and earns income from a pass-through entity, then the taxpayer may deduct 20% of that pass-through business income.<sup>148</sup> The deduction reduces taxable income, but not adjusted gross income.<sup>149</sup> If pass-through owners exceed the income threshold, but their pass-through business is not in one of the prohibited fields, then they are still eligible for the 20% deduction, limited to the greater of (a) 50% of W-2 wage income, or (b) 25% of wage income plus 2.5% of the basis of qualified business property.<sup>150</sup>

It seems the primary justification for the pass-through deduction stems from the argument articulated by many pass-through business owners that enacting a rate cut for corporations with no tax advantages for pass-through businesses was simply unfair.<sup>151</sup> It is important to note that the largest share of benefit from the new pass-through deduction will accrue to high-income taxpayers, since, as may be obvious, pass-through is not, in fact, synonymous with small business.<sup>152</sup> Many big businesses will benefit from the deduction.<sup>153</sup>

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145. LAURA E. CUNNINGHAM & NOËL B. CUNNINGHAM, *THE LOGIC OF SUBCHAPTER K: A CONCEPTUAL GUIDE TO THE TAXATION OF PARTNERSHIPS 1* (West Academic Publishing, 5th ed. 2017).

146. § 199A.

147. § 199A(b)(3).

148. § 199A.

149. *Id.*

150. § 199A(b)(1).

151. See Daniel Halperin, *Corporate Rate Reduction and Fairness to Passthrough Entities*, 147 TAX NOTES 1299, 1299 (2015) (presenting the issue of lack lower tax rates for pass-through entities).

152. See Lucas Goodman et al., *Simulating the 199A Deduction for Pass-Through Owners 18* (Office of Tax Analysis, Working Paper No. 118, 2019), <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-118.pdf>.

153. *Id.*

#### 4. Other Business Tax Provisions

Historically businesses could deduct all interest incurred in the ordinary course of a trade or business.<sup>154</sup> The TCJA imposed a cap on the interest expense deduction, such that now interest may only be deducted in an amount equal to 30% or less of the business's earnings.<sup>155</sup> The TCJA also repealed the corporate AMT, historically assessed as a 20% tax on a specifically defined amount of income.<sup>156</sup> Finally, the TCJA changed the way businesses can deduct their Net Operating Losses (NOLs).<sup>157</sup> Historically NOLs could be carried back two years and carried forward twenty years and could be used to offset up to 100% of a taxpayer's taxable income.<sup>158</sup> Beginning in 2018, NOLs may not be carried back, but may be carried forward indefinitely, with the added restriction that they may not exceed 80% of a taxpayer's taxable income.<sup>159</sup>

#### D. WEALTH TRANSFER TAX PROVISIONS

While Republican lawmakers have repeatedly called for the full repeal of the estate tax, and the original blueprint published by the Trump administration before either Congressional bill was released also urged its repeal, the estate tax survives in the TCJA.<sup>160</sup> However, the dramatic increase in the amount of the estate tax lifetime exemption continues the trajectory of eviscerating the tax. Starting with the increase of the exemption under George W. Bush from \$675,000 to \$1,000,000, the exemption level of the estate tax has dramatically increased over the past two decades.<sup>161</sup> The TCJA doubled the exemption level to \$11.2 million per individual, or \$22.4 million per married couple, with the full amount of an individual's estate tax exemption portable to that taxpayer's surviving spouse.<sup>162</sup> Under 2017 law, the estate tax was only applicable to about 0.2% of estates annually.<sup>163</sup> While final return information for 2018 has not yet been released, estimates are that

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154. I.R.S. Pub. 535, 3 (Jan. 25, 2019).

155. Donaldson, *supra* note 1, at 31.

156. *Id.* at 41.

157. *Id.* at 32.

158. *Id.*

159. *Id.*

160. Donaldson, *supra* note 1, at 45 (“[T]he house bill called for eventual repeal of the federal estate and generation-skipping transfer taxes, accompanied with a reduced tax rate of 35 percent for purposes of the federal gift tax. But the Senate settled simply for doubling the basic exclusion amount and leaving the tax rate alone.”).

161. Bird-Pollan, *supra* note 44, at 863-64.

162. § 2010.

163. Chye-Ching Huang and Chloe Cho, *Ten Facts You Should Know About The Federal Estate Tax*, CTR. ON BUDGET AND POL'Y PRIORITIES (Oct. 30, 2017), <https://www.cbpp.org/sites/default/files/atoms/files/1-8-15tax.pdf>.

the number of returns will drop by half, to about 0.1% of all estates.<sup>164</sup> Commentators worry that the most significant impact of this reduction in the estate tax will be its effect on charitable giving.<sup>165</sup> Since charitable contributions made out of the estate are fully deductible, the existence of the estate tax serves as an incentive to make charitable contributions part of a taxpayer's estate plan.<sup>166</sup> The larger the amount of an estate that is sheltered from tax under the exemption, the less motivation any particular taxpayer has to make a charitable contribution upon death.<sup>167</sup>

#### E. INTERNATIONAL TAX PROVISIONS

Many commentators find the reforms in the international tax arena to be the most successful of the changes coming out of the TCJA.<sup>168</sup> Analysts of all political stripes have long viewed U.S. international tax law as ripe for reform. The TCJA goes a long way towards improving U.S. tax law with regard to cross-border tax issues. Under previous law, all U.S. taxpayers, including corporations, incurred U.S. tax liability on worldwide income.<sup>169</sup> However, U.S. taxpaying corporations that earned income abroad through foreign subsidiaries were not required to pay U.S. income tax on those foreign earnings until the earnings were repatriated to the United States in the form of a dividend.<sup>170</sup> This rule led companies to accumulate earnings abroad, a tendency that was exacerbated by Congress's regular enactment of one-time "repatriation holidays," which were usually accompanied by admonishments that such a holiday would not come again.<sup>171</sup> Because corporate managers believed that, if they held out long enough, Congress would offer another repatriation holiday, there was further incentive not to repatriate earnings and pay the accompanying tax.<sup>172</sup>

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164. Howard Gleckman, *Only 1,700 Estates Would Owe Estate Tax in 2018 Under the TCJA*, TAX POL'Y CTR., (Dec. 6, 2017), <https://www.taxpolicycenter.org/taxvox/only-1700-estates-would-owe-estate-tax-2018-under-tcja>. ("[The Tax Policy Center] estimates that under either the House or Senate bill, the number of estates subject to the federal estate tax in 2018 would fall from about 5,500 to just 1,700, equal to less than 0.1 percent of all deaths. And the amount of estate tax they'd owe next year would shrink from \$20.4 billion to \$13.6 billion.")

165. Joyce Beebe, "The Estate Tax After the 2017 Tax Act," RICE U. BAKER INST. FOR POL'Y 1, 2 (Apr. 17, 2018), <https://scholarship.rice.edu/bitstream/handle/1911/102742/bi-brief-041718-cpf-estatetax.pdf?sequence=1>.

166. *Id.* at 2.

167. *Id.* at 2-3.

168. Kamin et al., *supra* note 115, at 1489.

169. CHARLES H. GUSTAFSON ET AL., *TAXATION OF INTERNATIONAL TRANSACTIONS* 32 (West Publishing Co., 2nd ed. 2001).

170. *Id.* at 30.

171. Thomas J. Brennan, *Where the Money Really Went: A New Understanding of the ACJA Tax Holiday*, NW. L. & ECON. 3 (Aug. 19, 2013), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2312721](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2312721).

172. *Id.*

The TCJA effectively changes the U.S. system from a system of worldwide taxation to a territorial system. All dividends received by U.S. corporations from foreign corporations are now exempted from U.S. income tax, if the U.S. shareholder holds more than 10% of the foreign corporation's stock.<sup>173</sup> This new territorial rule applies to all distributions made after December 31, 2017.<sup>174</sup> The territorial approach is the form of taxation imposed by almost all other major industrialized countries in the world, and so most commentators believe this change, combined with the new lower statutory corporate tax rate discussed above, will help the United States become more tax competitive in the international arena.<sup>175</sup>

In order to combat the revenue loss of the new territorial regime, the TCJA imposes a one-time deemed repatriation tax on all overseas Accumulated Earnings and Profits.<sup>176</sup> This one time transition tax is assessed at the rate of 15.5% for cash E&P and 8% for E&P in all other forms.<sup>177</sup> While this will raise some revenue (a predicted \$339 billion), it is a one-time tax, and is primarily necessary to ease the transition between the pre- and post-territorial systems.<sup>178</sup> Some commentators argue that the rate for this transition tax is much too low, and should, at a minimum, be imposed at the same rate as the new, lower corporate tax rate.<sup>179</sup>

Some elements of the TCJA are specifically aimed at combatting the most common forms of abuse seen in international tax law.<sup>180</sup> In particular, the tax on GILTI (Global Intangible Low-Taxed Income) under the TCJA is imposed at an effective rate of 10.5%.<sup>181</sup> Further, the Base Erosion Anti-Abuse Tax (BEAT) is imposed as an extra 10% of related party payments like royalties, interest, etc.<sup>182</sup> These provisions track efforts by the OECD to combat Base Erosion and Profit Shifting (BEPS) throughout the world.<sup>183</sup>

Advocates of the move to a territorial system argued that the change would reduce the number of corporate inversions made by U.S. corporations, since, under a territorial system, a corporation should be indifferent to

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173. Kamin et al., *supra* note 115, at 1489.

174. *Tax Cuts and Jobs Act: A Comparison for Large Businesses and International Taxpayers*, IRS (last updated June 28, 2019), <https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-a-comparison-for-large-businesses-and-international-taxpayers>.

175. Alan J. Auerbach, *Measuring The Effects of Corporate Tax Cuts*, 34 J. ECON. PERSPECTIVES, no. 4, 97, 108 (2018).

176. *Id.* at 112.

177. *Id.* See also Jordan M. Barry, *The Transition (Under -) Tax 1* (July 11, 2019) (unpublished manuscript) (on file with author).

178. *Id.*

179. *Id.* at 5.

180. Kamin et al., *supra* note 115, at 1488.

181. *Id.* at 1489.

182. *Id.* at 1507.

183. Auerbach, *supra* note 175, at 111.



whether income is earned in the United States or abroad.<sup>184</sup> However, some corporations announced plans to invert, even after the law change.<sup>185</sup> For instance, Dana, Inc., an Ohio-based auto parts supplier, announced in March 2018 that it planned to move its headquarters to the United Kingdom.<sup>186</sup> The company estimated that, even with new U.S. territorial tax plan, a move to the U.K. would save the company \$600 million over the next several years.<sup>187</sup> While a territorial tax system reduces the imposition of double tax on U.S. corporations earning income abroad, it cannot fully eliminate the disparities between taxes in other countries and taxes in the United States. All other things being equal, countries with lower tax rates than the United States will still be attractive places to organize a company, earn income, and pay tax.

#### PART IV: DISTRIBUTIONAL EFFECTS/REVENUE COSTS

Multiple groups have produced estimates of the distributional effects and revenue costs of the TCJA. The nonpartisan Joint Committee on Taxation (JCT) is generally accepted as a reliable source of information regarding the economic effects of all proposed legislation. The JCT's estimates regarding the TCJA are divided among the effects before the repeal of the temporary provisions due to the sunset clauses, and the effects after the sunset.<sup>188</sup> Before the effect of the sunset (from 2018-2027), the JCT estimates that the revenue cost of the TCJA will be \$779 billion from the individual income tax provisions detailed above, \$83 billion from cuts to the estate tax, \$265 billion from the pass-through deduction, and \$329 billion from the corporate tax cuts, for a total cost of approximately \$1.5 trillion over the next ten years.<sup>189</sup> If the tax cuts scheduled to sunset are extended, then the cost increases to \$2 trillion.<sup>190</sup> By contrast, if the individual income tax cuts are allowed to expire, then 2027 will see \$87 billion of revenue generated by the elimination of those individual income tax provisions.<sup>191</sup>

On the distributional side, most commentators agree that the large majority of the benefit of the tax cuts enacted under the TCJA will accrue to

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184. Kamin et al., *supra* note 115, at 1496.

185. James Aselta, et al., *Is Cash Still Trapped*, STRATEGIC FIN. (Apr. 1, 2019), <https://sfmagazine.com/post-entry/april-2019-is-cash-still-trapped/>.

186. *Id.*

187. *Id.* ("Dana's CFO noted that, 'The Company expects that even under the Tax Cuts and Jobs Act, this move will reduce its tax liability by around \$600 million over several years.' But this inversion never materialized since GKN's board of directors accepted a new offer from Melrose Industries several weeks later.")

188. See JCT Estimated Budget Effects, *supra* note 92.

189. *Id.*

190. *Id.*

191. *Id.*

higher-income and wealthy taxpayers.<sup>192</sup> The JCT estimates that, for instance, in 2019 households in the \$10,000-\$20,000 income category will see an after-tax increase of 0.5% in their income, while the largest benefit - a 4.5% increase in after-tax income - will go to households in the \$500,000-\$1,000,000 income range.<sup>193</sup> Also notable, if the individual income tax provisions in the TCJA expire as scheduled, 2027 will see a 1.5% decrease in after-tax income for households in the \$10,000-\$20,000 category, while households in the \$500,000-\$1,000,000 will see a 0.4% increase in their after-tax income in that year, even with the expiration of the TCJA provisions.<sup>194</sup>

#### PART V: CONCLUSION

The TCJA is the most significant tax reform in over thirty years. Unlike major tax reforms enacted in the past, it was passed entirely along party lines, garnering not even one vote of support from Democratic lawmakers in the House of Representatives<sup>195</sup> or the United States Senate.<sup>196</sup> This deeply partisan version of lawmaking resulted in a bill the majority of which is destined to expire at the end of 2025.<sup>197</sup> As a result, Washington will find itself faced with the question of tax reform again very soon. One hopes that legislators faced with the impending expiration of this tax bill will work across party lines to create a more lasting piece of legislation that echoes the tax reform work of the past.

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192. Dylan Scott and Alvin Chang, *The Republican Tax Bill Will Exacerbate Income Inequality in America*, Vox.com (December 4, 2017), <https://www.vox.com/policy-and-politics/2017/12/2/16720952/senate-tax-bill-inequality>.

193. JCT Estimated Budget Effects, *supra* note 92.

194. *Id.*

195. <https://www.nytimes.com/interactive/2017/12/19/us/politics/tax-bill-house-live-vote.html>.

196. [https://www.senate.gov/legislative/LIS/roll\\_call\\_lists/roll\\_call\\_vote\\_cfm.cfm?Congress=115&session=1&vote=00303](https://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?Congress=115&session=1&vote=00303).

197. Herve T. Zeida, *The Tax Cuts and Jobs Act (TCJA): A Quantitative Evaluation*, ECON. DYNAMICS (Feb. 15, 2018), [https://economicdynamics.org/meetpapers/2018/paper\\_1131.pdf](https://economicdynamics.org/meetpapers/2018/paper_1131.pdf).