

TAX POLICY: NEW IDEAS AND STATE-LEVEL IMPACTS OF TCJA

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The Tax Debate



- Heading into the 2020 elections, Republicans and Democrats have been arguing on behalf of competing tax policy ideas
- The pros and cons of the 2017 tax cuts will likely be debated in the presidential and Congressional races
 - ▣ Candidates and analysts will examine key changes, including the new cap for a deduction that benefits residents of high-tax states
- At the same time, prominent Democrats – including candidates for president – have floated alternative ideas for taxes
 - ▣ While Republicans tout tax cuts as a way to fuel economic growth, Democrats are considering higher taxes on the wealthy as a way to decrease inequality and fund ambitious programs

Tax Cuts and Jobs Act of 2017

- Signed into law on December 22, 2017 by President Trump, the Tax Cuts and Jobs Act:
 - ▣ Reduces most income tax rates for individuals and increases standard deduction
 - ▣ Repeals personal exemptions and limits some itemized deductions, including for state and local taxes (SALT)
 - ▣ Permanently reduces corporate taxes, replacing current structure (with top rate of 35%) with a single 21% rate
- CBO estimates law will increase deficit by nearly \$1.5 trillion over 10 years

SALT Debate



- New law caps SALT deduction, which previously was unlimited
 - ▣ Taxpayers allowed to deduct state and local income, sales and property taxes up to a total of \$10,000
 - ▣ The final language was a compromise
 - Early Republican framework called for eliminating SALT
 - Republicans from high-cost, high-tax states insisted at least partial preservation
 - ▣ Proponents for getting rid of the deduction say it disproportionately benefits high-earners
 - ▣ Opponents say ending SALT would burden states that rely on the provision as de facto subsidy (making it easier for states to raise taxes)

Sources: CNN Money, Vox, Tax Foundation

SALT Change's Impact on State



- New York State Gov. Andrew Cuomo blames SALT changes for increasing the state's deficit
 - ▣ Some experts cite the stock market performance and smaller Wall Street bonuses in 2018 as the likely explanation for the growing deficit
- Gov. Cuomo warns deficit will get worse if wealthy residents change their primary residence to save on taxes (he didn't offer proof that this was happening yet)
 - ▣ ***"On any level, how is this fair?" Gov. Cuomo says***



NYS Gov. Andrew Cuomo.
Photo credit: Diana Robinson,
Wikimedia Commons

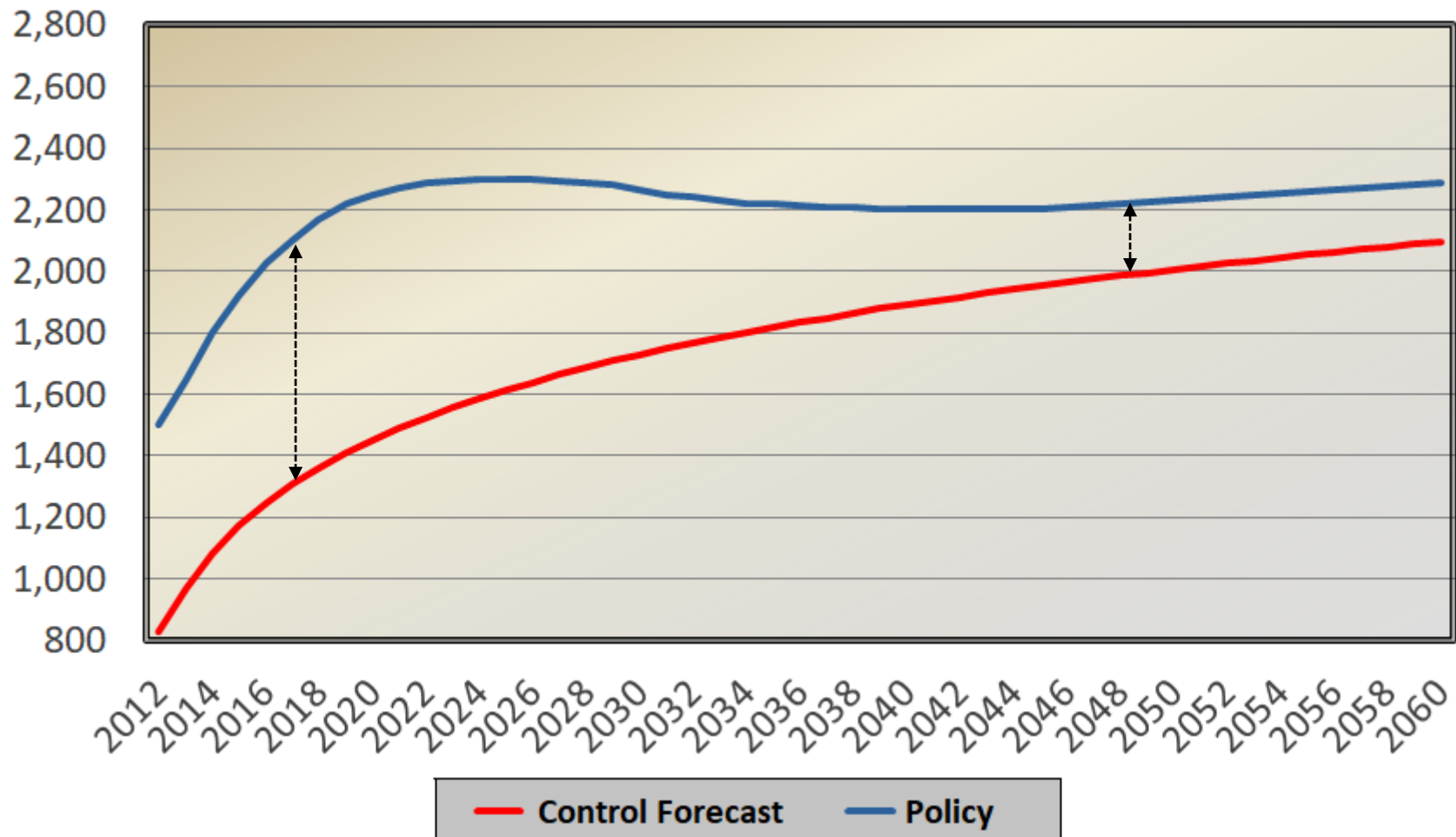
Source: WAMC/Northeast Public Radio

Modeling Scenario



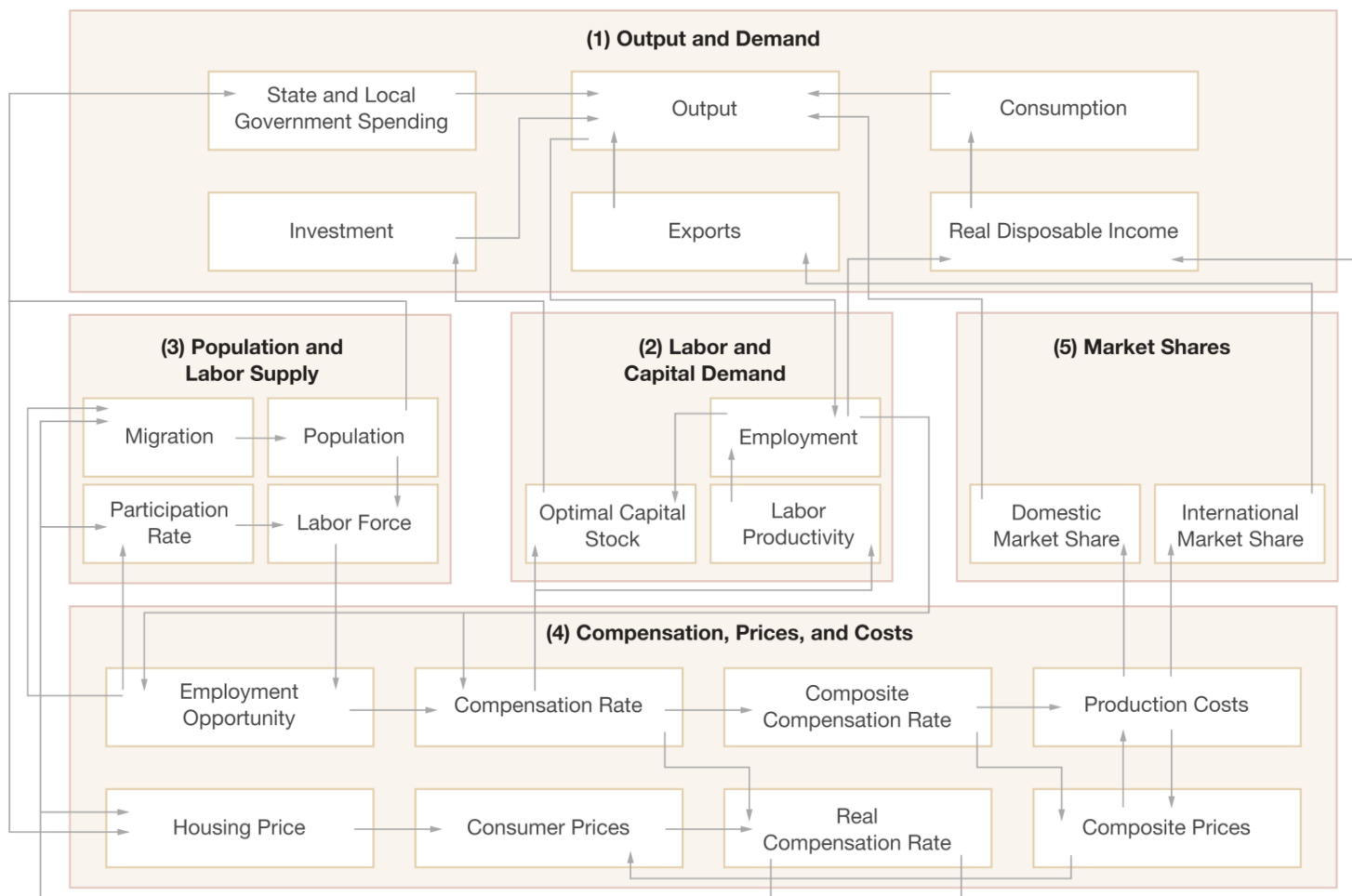
- Cap SALT Deductions at \$10,000
 - ▣ Effect on Taxpayers taking Itemized Deduction
- Scope of Analysis: 50 states + D.C., 2018-2022

Model Framework



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Model Structure



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Cap SALT Deductions



□ Methodology, data sample (IRS)

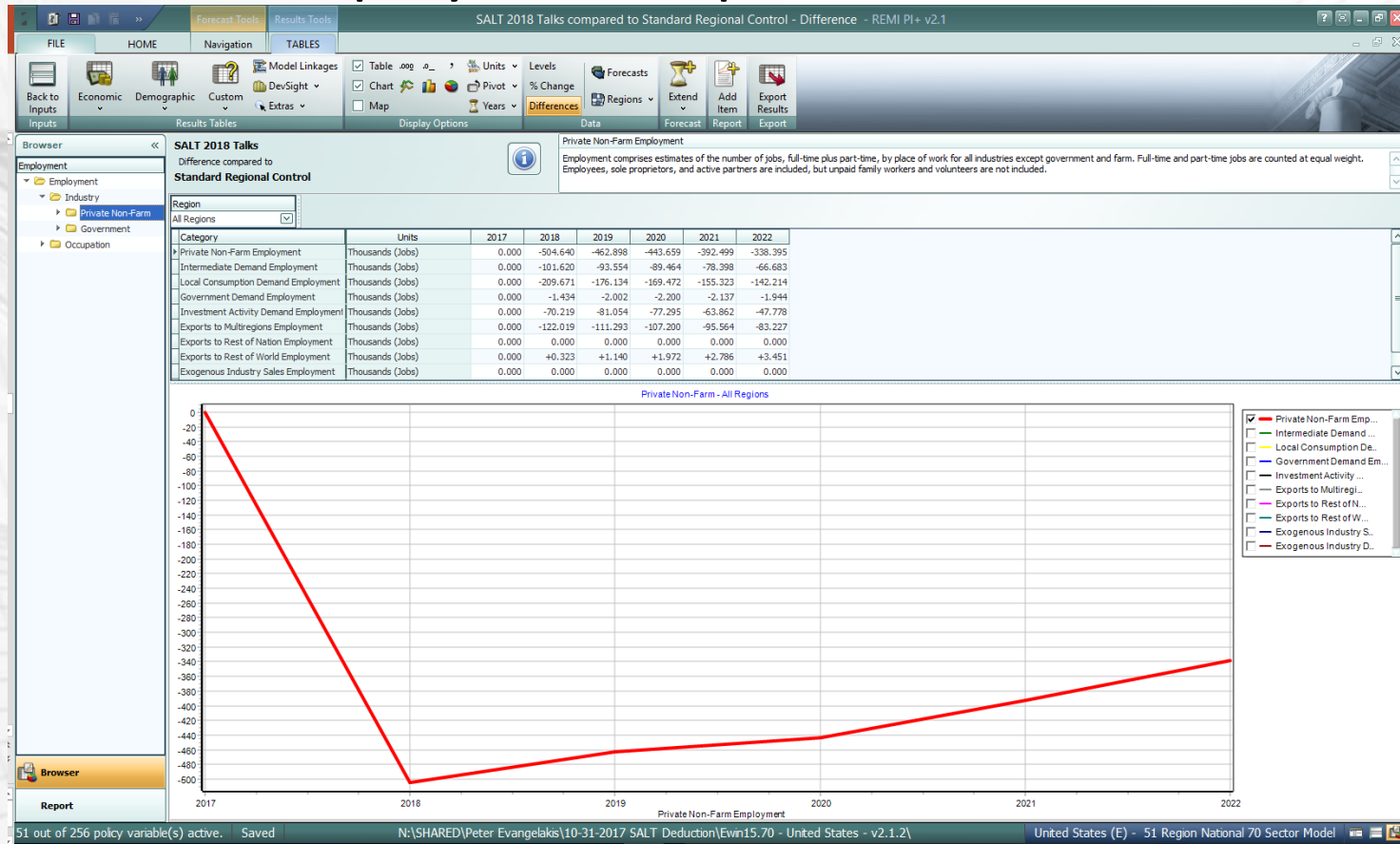
State	SALT Returns (Millions)	Total Deduction with \$10K Deduction (Billions)	Total SALT Deduction (Billions)	Difference in SALT Deduction (Billions)	Excess SALT Deduction (Billions)	Excess SALT Deduction, 20% Tax (Billions)
Alabama	0.52939	5.2939	2.981157	-2.312743	0	0
Alaska	0.07715	0.7715	0.3695	-0.402	0	0
Arizona	0.80141	8.0141	5.626575	-2.387525	0	0
Arkansas	0.27653	2.7653	2.438026	-0.327274	0	0
California	5.89631	58.9631	101.11201	42.148911	42.148911	8.4297822
Colorado	0.83032	8.3032	7.139648	-1.163552	0	0
Connecticut	0.71806	7.1806	13.599857	6.419257	6.419257	1.2838514
Delaware	0.14057	1.4057	1.237089	-0.168611	0	0

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Cap SALT Deductions



□ National employment impacts

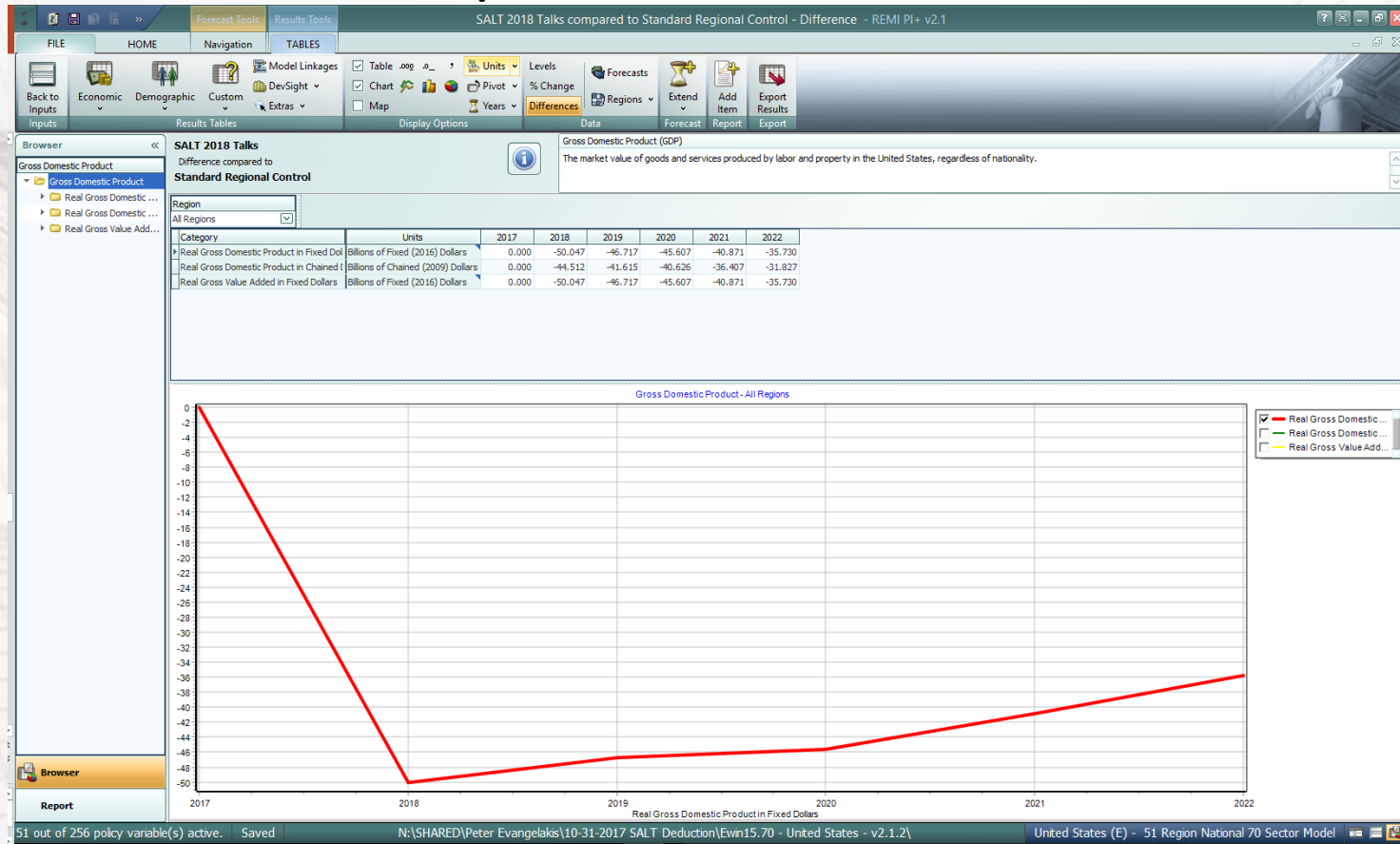


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Cap SALT Deductions



□ National GDP impacts

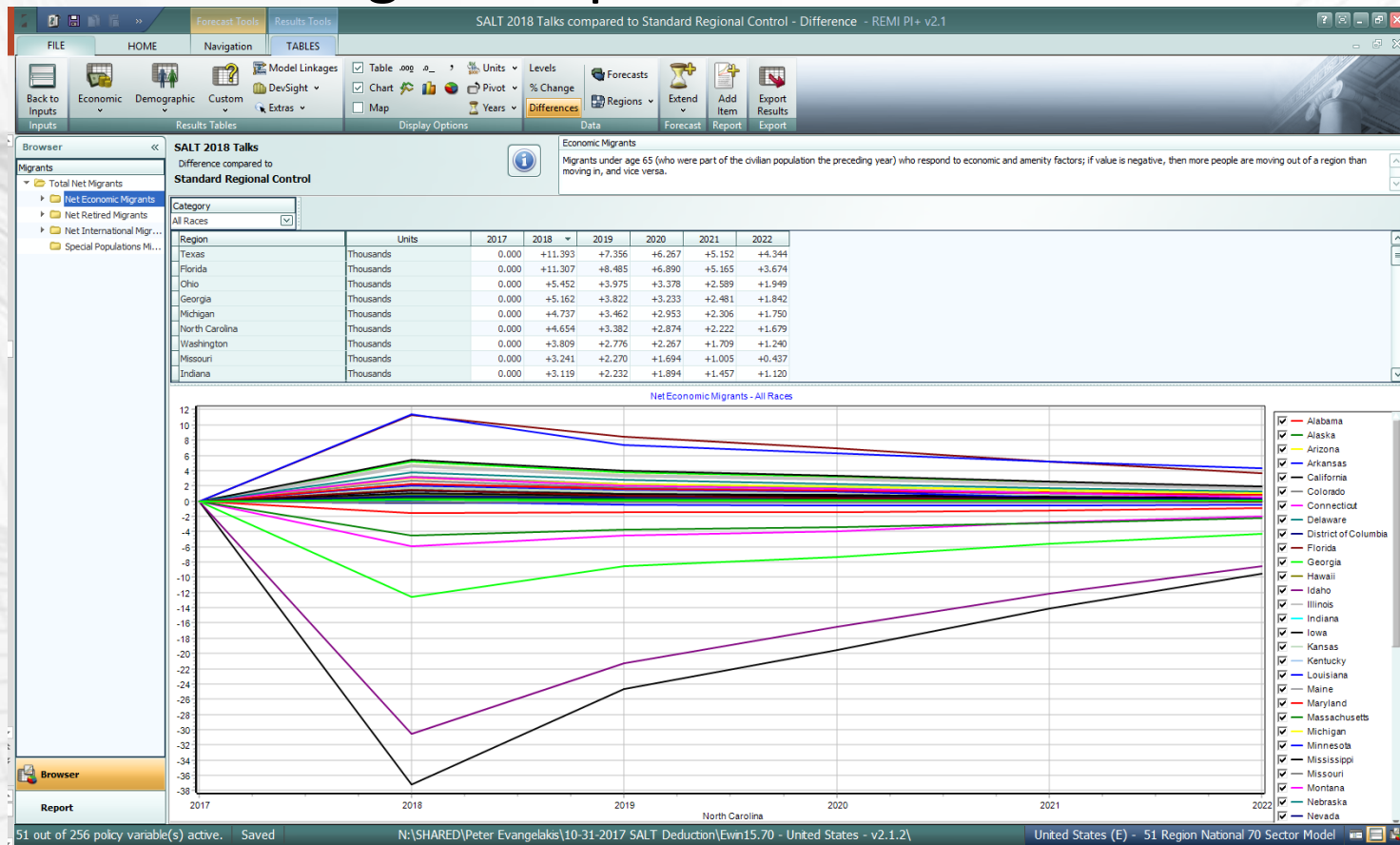


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Cap SALT Deductions



□ Economic migration patterns



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Democratic Tax Ideas



- Rep. Alexandria Ocasio-Cortez has proposed raising taxes on very high earners
 - ▣ Up to a 70% marginal tax rate on \$10M+ income
- Sen. Elizabeth Warren proposes imposing a wealth tax rather than income tax
 - ▣ 2% tax on households worth \$50M+, help pay for universal child care plan
- Sen. Bernie Sanders proposes expanding the inheritance tax
 - ▣ Lower threshold from \$22.8 million to \$7 million for married couples, and raise rate from flat 40% to minimum 45% (up to 77% for billionaires)
- Sen. Kamala Harris's middle class tax cut
 - ▣ Refundable tax credit up to \$6,000 for HHs making under \$100,000, up to \$3,000 for single filers making under \$50,000
- Sen. Cory Booker's savings account proposal
 - ▣ Give every child a savings account, pay with higher capital gains and estate taxes

Tax Scenario



- What if the federal government enacts a 70% marginal tax rate on incomes over \$10M, as Rep. Ocasio-Cortez suggests?
 - ▣ 3,755 high earners directly affected
 - ▣ \$14.8B in additional revenue raised (37% to 70% rate)
- One use for this additional revenue would be a middle class tax cut (e.g., Sen. Harris's proposal) of the same magnitude
 - ▣ Populist idea to redistribute income
 - ▣ What are the economic impacts?

Economic Impacts

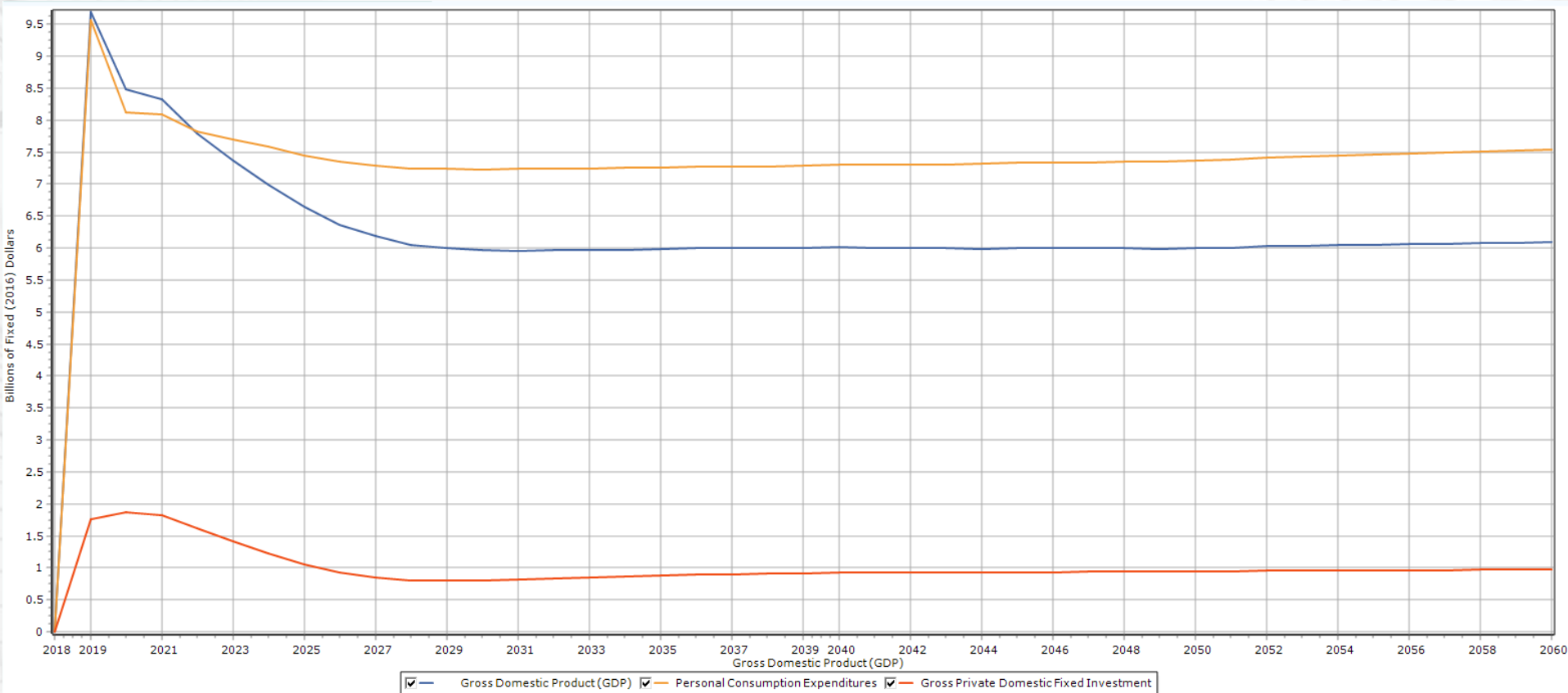


- Decrease in disposable income, consumption for high earners
 - High savings rate means some disposable income would have been saved instead of spent (38% for top 1%): -\$9.2B
- Increase in disposable income, consumption for middle class
 - Close to zero savings rate for many low- and middle-income earners, so spend basically whole tax cut: +\$14.8B
 - On net, increase in consumption spending is stimulative
- Overall decrease in savings may raise the cost of capital
 - Less investment capital, investors demand higher return
 - Raises capital costs for businesses, affects competitiveness, counteracts spending stimulus: +0.045% wipes it out

Increased Consumption



□ GDP + Consumption & Investment Impacts

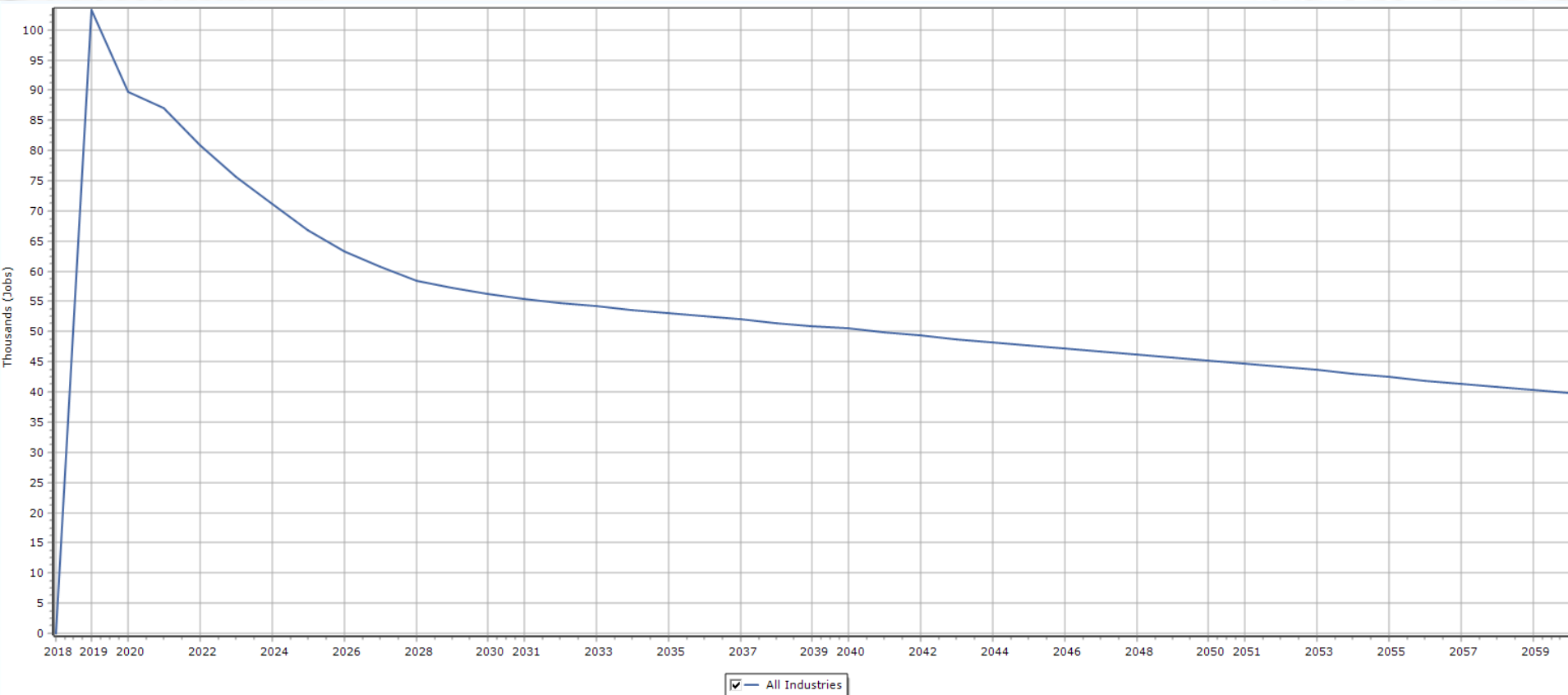


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Increased Consumption



□ Total Employment Impact

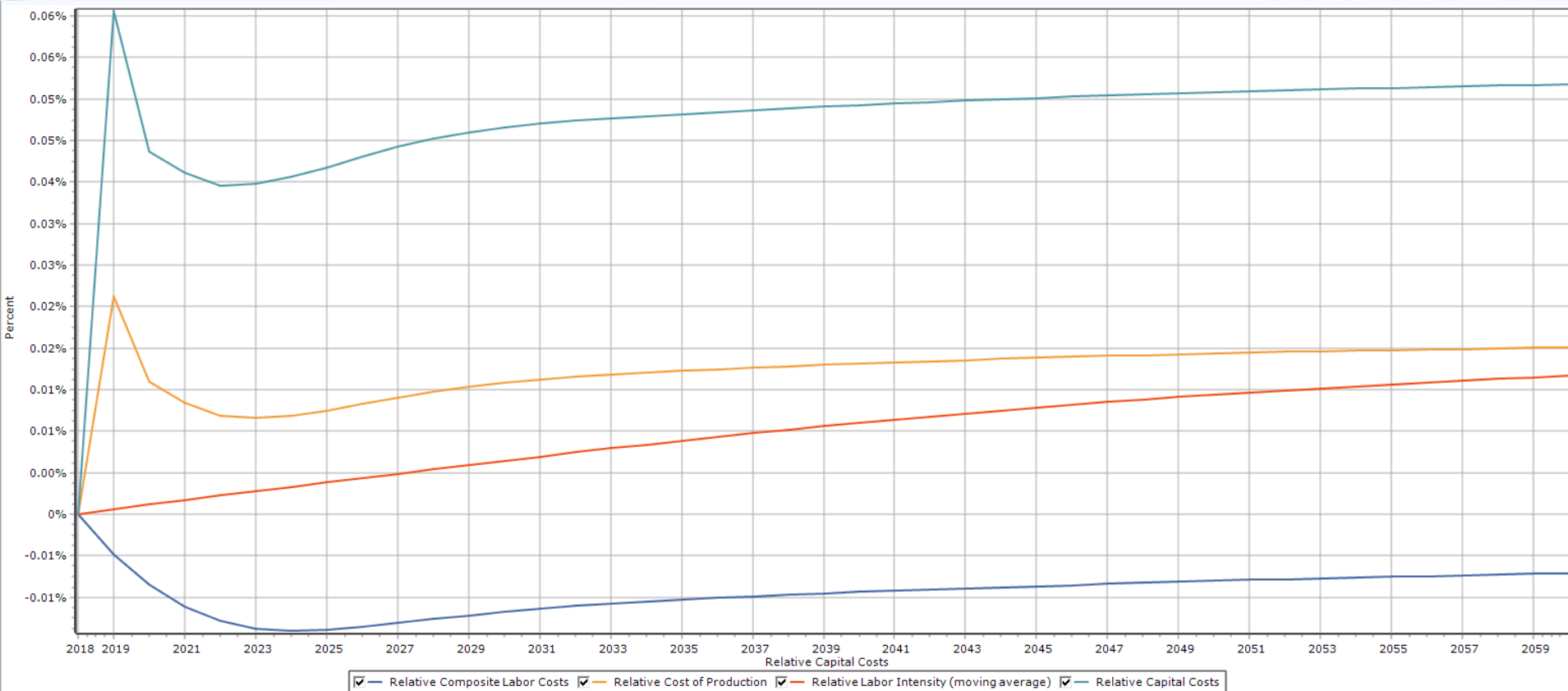


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Increased Capital Cost



□ Capital, Labor, Production Costs + Labor Intensity Impacts



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Increased Capital Cost



□ GDP + Consumption & Investment Impacts

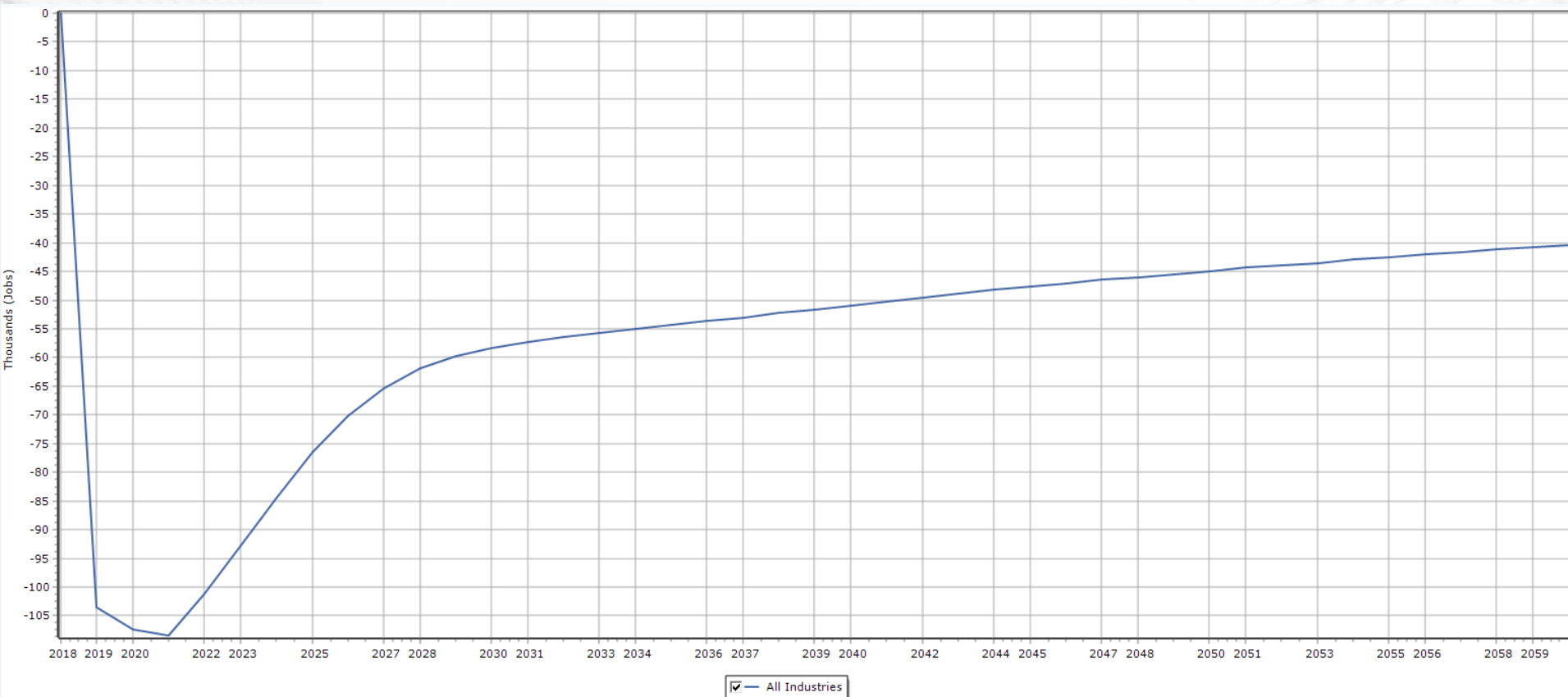


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Increased Capital Cost



□ Total Employment Impact

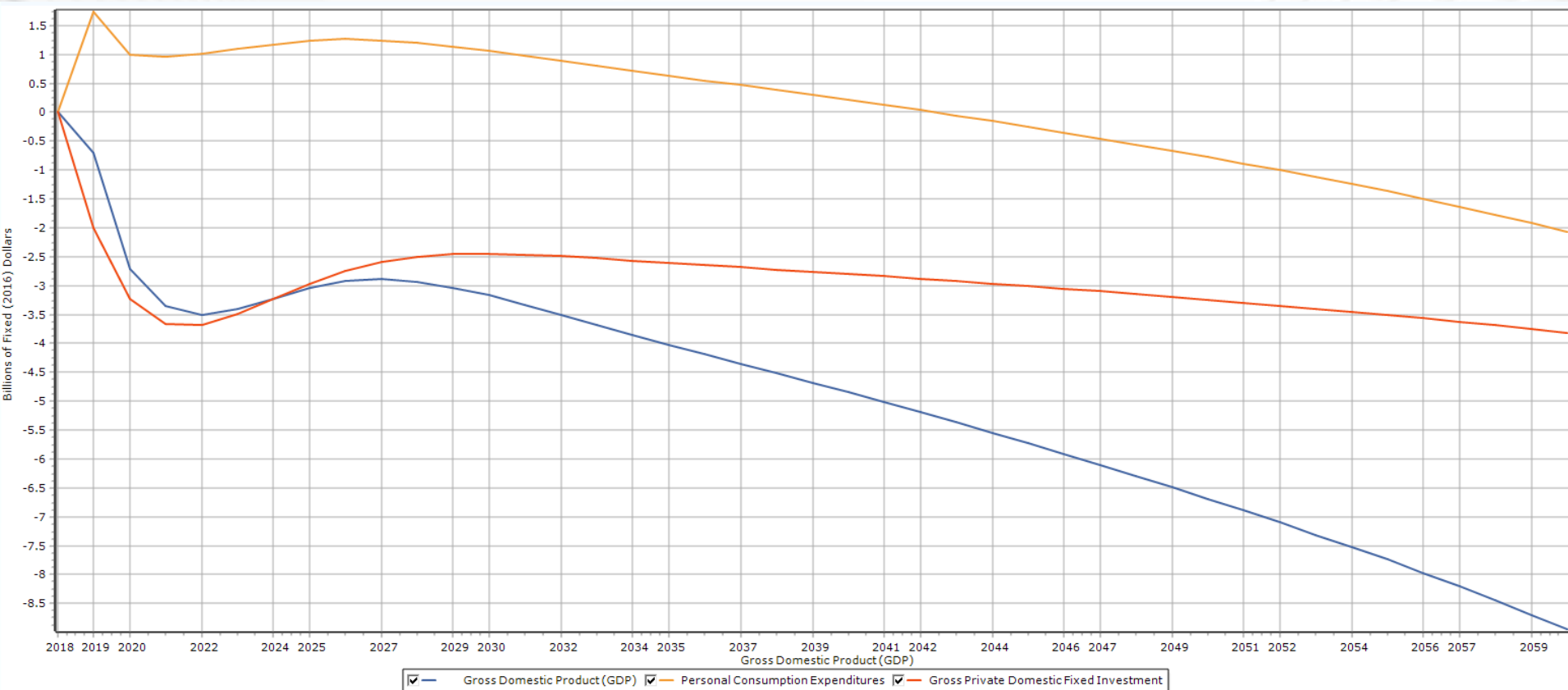


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Combined Impacts



□ GDP + Consumption & Investment Impacts

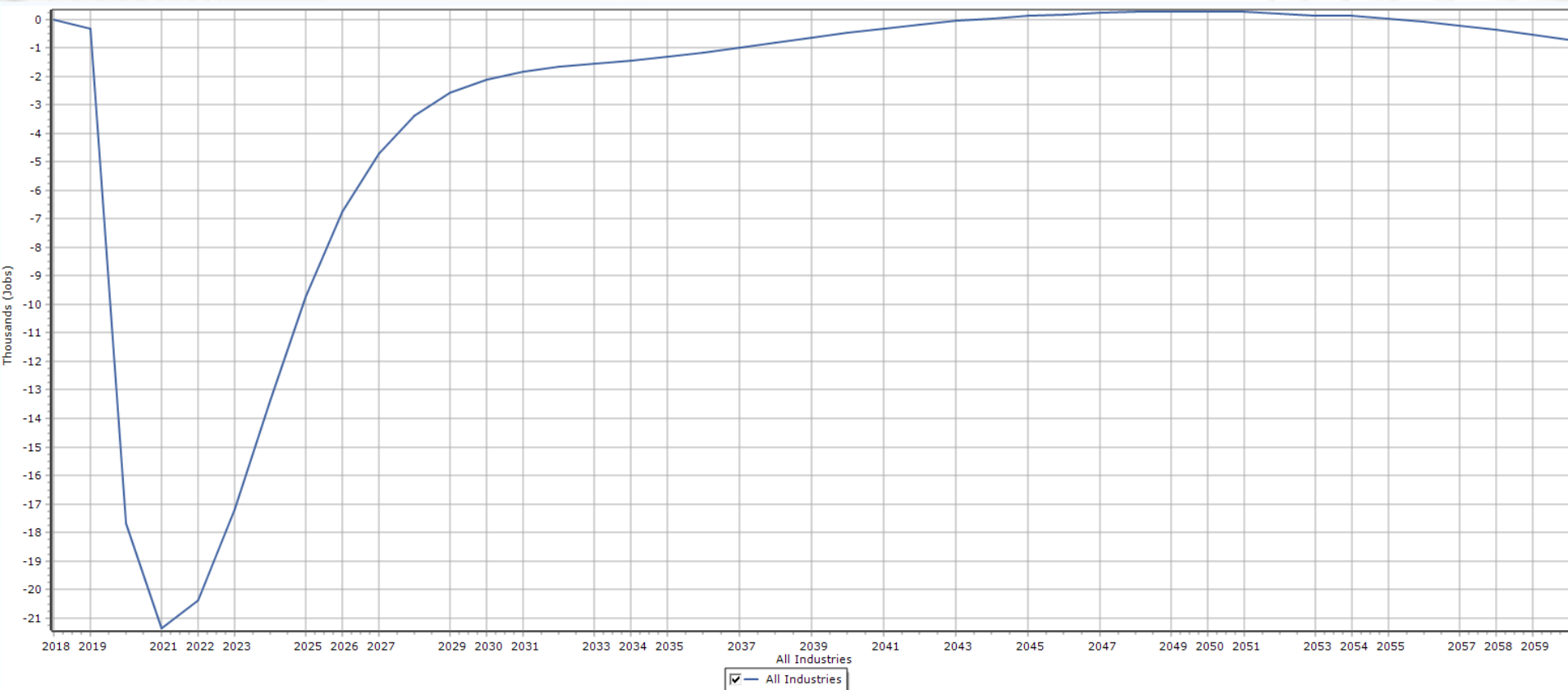


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Combined Impacts



□ Total Employment Impact

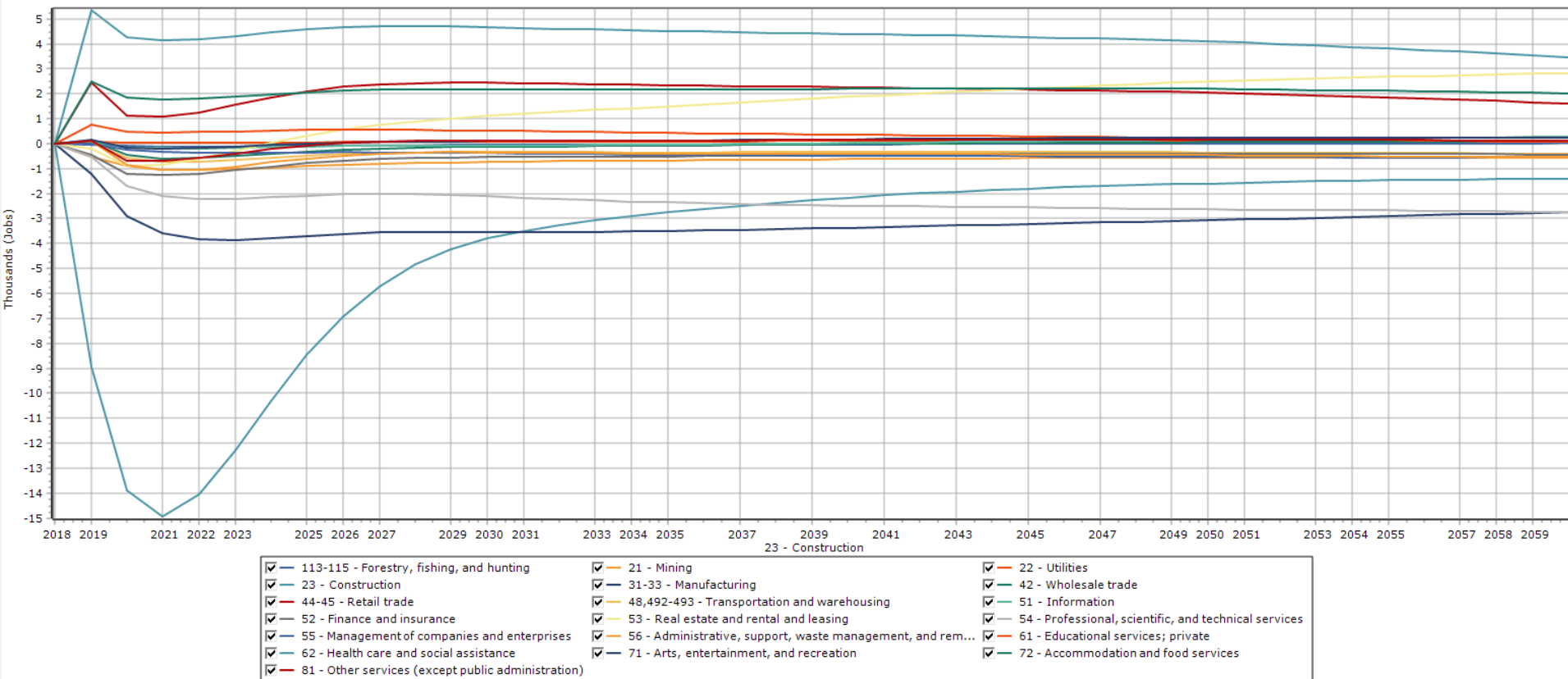


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Combined Impacts



□ Employment Impacts by Industry



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Conclusion



- ❑ Tax policy has significant economic implications
- ❑ Especially pronounced on a state level, due to being relatively small open economies
- ❑ Important to consider fiscal ramifications
- ❑ Business cycle considerations (labor market, capital costs, housing supply)
- ❑ Look equally at where the money is going vs. how it is being raised