# How Tax Reformers Can Add $500 Billion in Family Tax Cuts Without Gutting Business Tax Reform

**Brian Riedl**

Within the tax reform bills produced by the House Ways and Means Committee and the Senate Finance Committee, there lies a potential $1.5 trillion compromise that:

- Doubles the child tax credit to $2,000, provides a permanent $300 family tax credit, and expands the EITC;
- Nearly doubles the standard deduction;
- Cuts the corporate tax rate to 20 percent, with territorial taxation and permanent business expensing;
- Eliminates the AMT, estate tax, and the proposed 46 percent "bubble tax";
- Includes small business tax cuts and itemized deduction limitations that can pass Congress; and
- Does this all without fake expirations after five years.

Overall, this "Bipartisan Blueprint" would add $500 billion in family tax cuts without eliminating any of the pillars of business tax reform.

Before presenting the blueprint, three caveats are in order. First, it generally stays within the House and Senate frameworks – it does not introduce new approaches unless absolutely necessary. Second, the blueprint makes compromises to political reality that may dishearten economic purists. Third, it surely includes a least a couple policies that will frustrate conservatives, liberals, economists, lobbyists, and families.

Overall, it attempts to thread the needle of sound economics and political reality.

**Begin by Combining House Individual Provisions with Senate Business and International Provisions**

Based on the Joint Committee on Taxation (JCT) bill scores released on November 9th (Senate) and November 11th (House), the blueprint first groups each bill's provisions into three categories:

- "Individual tax provisions" – which consists of Section I of each JCT score, minus the line-items for pass-through tax relief, pass-through active losses, and estate/gift tax reform.
- "Business tax provisions" – which consists of Sections II, III, IV of each JCT score, plus the Section I line-items for pass-through tax relief and pass-through active losses.
- "Estate/gift tax provisions" – which consists of the estate/gift tax line-item from Section I.

These are merely grouping differences that do not reflect any policy change.

The blueprint begins by combining the House individual tax provisions with the Senate business tax provisions. The first reason is cost: The House individual tax provisions ($216 billion as adjusted above) cost less than half of the Senate individual provisions. On the business side, the Senate plan ($877 billion as adjusted above) costs nearly $200 billion less than the House plan. Adding in the House's (more expensive) $151 billion estate tax repeal brings the total starting cost to $1,244 billion over the decade.

Sensible policy drives this starting point as well. The House line-item for individual income tax rate changes not only costs $237 billion less than that of the Senate, it also more efficiently consolidates into four tax brackets (plus a bubble rate), compared to seven Senate tax brackets. The House bill eliminates more small tax preferences than the Senate bill, and provides a (five-year) family tax credit. The House bill's distributional tables have been less kind to middle- and lower-income families than some would prefer, yet more resources are added below. While both bills include nearly identical savings from limiting itemized deductions, the Senate version that fully eliminates the state and local tax deduction (rather than retaining most of the property tax deduction) likely cannot pass the House. Overall, the House individual tax provisions offer strong tax policy at half the cost of the Senate individual tax provisions.

Yet the Senate bill has superior business tax reforms. The 17.4 percent deduction for small businesses is simple and efficient, and the Senate's more modest small business expensing provisions do not phase out over five years like those in the House plan. The Senate bill includes a tighter business interest deduction, and stronger base erosion provisions accompanying territorial taxation. The Senate proposal to disallow certain active pass-through losses raises $176 billion over the decade. Given the 20 percent corporate tax rate, territorial taxation, and business expensing, it is not unfair to tighten these other policies.

This blueprint also accepts the House's full repeal of the estate tax. While wealthy families are not a sympathetic group, the estate tax double-taxes income that had already been taxed when earned. This tax also imposes an administrative burden on affected families that is disproportionate to the amount of tax revenue it raises. Thus, a majority of both Republicans and Democrats recently polled want this tax repealed.

**Next, Trim $256 Billion – and Then Give Families $512 Billion**

The merged House and Senate bills described above costs $1,244 billion. This provides significant room under the $1.5 trillion cap to improve the blueprint. Additional business and estate tax savings can lower the blueprint's tab by $256 billion – bringing the cost down to $988 billion – and thus allowing for $512 billion in additional benefits for middle- and lower-income families.

**1) Additional Business Revenues-Raisers ($166 billion)**

- **Phase-in corporate rate cuts over five years (saves: $163 billion) and make business expensing permanent (cost: $163 billion).** These provisions work together, and should roughly cancel out budgetarily. The corporate tax rate would be reduced from 35 percent to 20 percent in annual increments of three percentage points between 2019 and 2023, and the full business expensing reforms would be made permanent rather than expire in five years. While phasing in a tax cut is usually an anti-growth gimmick, in this case it would better align tax policy with the business investment timeline. Companies could immediately expand and make new investments – receiving an even larger tax benefit because it is against the higher initial tax rate – and then a few years down the road when the investments are yielding profit, they could catch the new, lower corporate tax rate. Businesses could also make long-term investment decisions with the confidence that business expensing will not expire. Together, these reforms would accelerate economic growth at little or no additional cost.
- **Bring back the higher House "toll charge" for multinationals (saves: $103 billion).** The House bill requires American multinationals with assets parked overseas to pay a one-time toll charge of 14 percent for their liquid assets abroad, and 7 percent for their illiquid assets (compared to rates of 10 and 5 percent in the Senate bill). For companies that will vastly benefit from territorial taxation, this higher transition cost should be acceptable.
- **Trim the pass-through deduction from 17.4 percent to 15 percent (saves: $63 billion).** The Senate pass-through deduction provides broad-based assistance to America's small businesses (and some larger ones too). These businesses will also benefit from expanded section 179 business expensing, lower marginal tax rates, and pro-growth corporate tax reforms that induce more purchases of small business inputs. Thus, the 15 percent tax deduction is sufficient and allows room for more family tax relief.

**2) Additional Estate Tax and Related Revenue-Raisers ($90 billion)**

- **Delay estate tax repeal until after 2025 (saves: $22 billion).** The House already amended the estate tax repeal to begin after 2024. Adding another year provides important savings.
- **Repeal step-up basis for inherited assets (saves: $68 billion).** The estate tax should be repealed because death should not be a taxable event. At the same time, death should not induce tax cuts either by allowing heirs to inherit profitable assets but not the accompanying capital gains tax liability on the pre-death gains. While repealing step-up basis presents modest administrative challenges, it is an acceptable price to pay for full estate tax repeal.

**3) Additional Family Tax Relief ($512 billion)**

- **Retain 39.6 percent bracket at current income thresholds, and eliminate "bubble tax" (no net cost).** The 39.6 percent tax bracket currently begins at a taxable income of $470,000 for married couples. The House plan would instead charge marginal rates of 35 percent between $470,000 and $1 million, 39.6 percent between $1.0 million and $1.2 million, 45.6 percent up to $1.6 million (the "bubble rate"), and then 39.6 percent thereafter. It would make sense – and cost the same or even a bit less – to simply leave it at 39.6 percent above $470,000 (and $418,400 for unmarried filers).
- **Make $300 family credit permanent (cost: $175 billion).** This new $300 tax credit that is targeted to middle- and lower-income families need not expire after five years.
- **Increase child credit from $1,600 to $2,000 (cost: $240 billion).** This expansion would significantly increase tax reform enthusiasm among middle- and lower-income families, and ensure that fewer families see net tax increases.
- **Expand EITC for childless workers (cost: $70 billion).** Both former President Obama and House Speaker Paul Ryan endorsed this policy of better helping childless families benefit from the Earned Income Tax Credit. Currently, childless workers cannot receive more than $510 per year from the EITC (and few are even eligible for that), while parents can receive between $3,400 and $6,318. This proposal to double the maximum credit and expand eligibility for childless workers would promote work, limit the pressure for less-effective policies like minimum wage increases, and ensure that those who do not benefit from the expanded child credit are not left behind,

- **Account for policy interactions, and relax controversial eliminations (cost: $27 billion).** The remaining room under the $1.5 trillion cap could be applied to possible interaction costs of these proposals. After that, lawmakers could revisit any controversial tax preference eliminations, such as in higher-education.

The Bipartisan Blueprint invests an extra $512 billion in lower- and middle-income families without significantly rewriting the bill or busting the $1.5 trillion cap – and while preserving the 20 percent corporate tax rate, territorial taxation, permanent business expensing, small business tax cuts, AMT repeal, and estate tax repeal.

The Tax Policy Center had scored the House plan as saving the typical middle-quintile family $320 in 2027. The blueprint would provide a typical married couple with two children with an additional $800 for the child credit and $600 for the now-extended family credit – quintupling the 2027 tax savings to $1,720. Conservatives who bristle at shifting much of the savings from the business to the family side should note that tax reform remains unlikely to pass Congress until it becomes more popular with families.

This blueprint includes some back-of-the-envelope calculations rather than an economic model. I aimed to error on the side of caution when scoring its provisions. However, a margin of error exists – especially from the interaction of different provisions. The blueprint sets aside $27 billion over the decade for these possible higher costs. If that is not enough to stay within the $1.5 trillion cap, lawmakers could delay estate tax repeal another year (saving $22 billion), begin taxing large credit unions that operate similarly to banks (saving $15 billion), pare back the child tax credit expansion (saving approximately $60 billion per $100 of credit), or adjust other dials. This blueprint is easily open to tweaks.

**The Byrd Rule Challenge**

The Byrd Rule forbids tax reform from increasing the budget deficit beyond 2027, which is the final year covered in the latest budget resolution. It is simply not possible to design a tax cut within the current House and Senate framework that legitimately eliminates all post-2027 deficits. This leaves three options:

1) **Secure 60 Senate votes to waive the Byrd Rule**. Shifting $512 billion to middle- and lower-income families should win over moderate Republicans as well as Democrats who also share Barack Obama's support for corporate tax reform.
2) **Pass a new budget resolution in January with a 30-year window**. Congress inexplicably created this ten-year problem by writing a ten-year budget resolution. Yet ten-year budget windows are not sacrosanct (they are a relatively recent phenomenon), and Congress in January could simply wait and pass a new 30-year budget resolution, which is an eternity in tax policy. Thirty-year budgets may feel messy, but so are ten-year sunset provisions that sabotage otherwise-sound tax policy.
3) **Sunset the higher standard deduction and individual tax rate cuts.** If Congress refuses the two options above, it will likely be forced to simply sunset much of the tax cuts after 2027. Sunsetting the business tax cuts would be extraordinarily damaging because the business investment that lawmakers are trying to stimulate will not occur without long-term tax predictability. That would leave lawmakers to sunset the higher standard deduction and family tax rate cuts with the hope that future Congresses would extend these popular provisions. Options one and two are far superior.

**Something for Everyone**

The Bipartisan Blueprint surely has something for everyone to dislike – yet has even more to support. While staying within the $1.5 trillion cap, it provides an additional $512 billion in benefits to lower- and middle-income families. At the same time, it cuts the corporate tax rate to 20 percent, provides permanent business expensing and territorial taxation, cuts taxes for small businesses, and repeals the estate tax and AMT. It even preserves the delicate state and local deduction compromise negotiated in the House. Tax reformers across the political spectrum should embrace these reforms.

*— Brian Riedl is a senior fellow at the Manhattan Institute. Follow him on twitter @Brian_Riedl.*

# Summary of the Bipartisan Blueprint

| Score | Provision |
|---|---|
| | **Beginning Score from Merged Bills*** |
| -$216 | House individual tax provisions (as defined below) |
| -$877 | Senate business tax provisions (as defined below) |
| -$151 | House estate tax repeal (after 2024) |
| **-$1,244** | **Initial Subtotal** |
| | |
| | **Additional Bill Savings ($256 billion)** |
| $163 | Phase-in corporate rate cut to 20 percent between 2019-2023 |
| -$163 | Make business expensing permanent (no 5-year sunset) |
| $103 | Higher House "toll charge" for multinationals |
| $63 | Trim small business deduction from 17.4 percent to 15 percent |
| $22 | Delay estate tax repeal one more year (until after 2025) |
| $68 | Repeal step-up basis for taxing inherited assets |
| **-$988** | **New Subtotal** |
| | |
| | **Additional Family Tax Cuts ($512 Billion)** |
| $0 | Retain current 39.6 percent tax rate and income threshold, no bubble rate |
| -$175 | Make family credit permanent (no 5-year sunset) |
| -$240 | Further expand child credit from $1,600 to $2,000 |
| -$70 | Expand EITC for childless workers |
| -$27 | Policy interaction costs, or eliminate small controversial provisions |
| **-$1,500** | **New Cost** |

Source: Beginning scores come from the Joint Committee on Taxation at JCX-52-17 (November 9, 2017), and JCX-54-17 (November 11, 2017). Figures reflect ten-year scores in $billions.

*Note: "Individual tax provisions" consists of Section I of the JCT scores, and "Business tax provisions" consists of Sections II, III, and IV – except for three line-items. For both the House and Senate bills, the new pass-through tax preference and the disallowance of certain pass-through losses were reclassified from the individual to the business category. And the estate/gift tax provision was reclassified from the individual to its own category. These are merely grouping differences that do not reflect any policy change.

Put differently, the beginning score of $1,244 billion consists of Section I of the House bill and Sections II and III of the Senate bill – except within Section I's pass-through provisions, it replaces House line-item I.A.5 with Senate line-items I.B.1 and I.B.2.