Some Background

What did the 2008–10 tax stimulus acts do?

Q. What did the 2008–10 tax stimulus acts do?

A. The 2008 and 2009 tax acts provided large temporary tax cuts to most households, with the goal of helping the economy recover from the Great Recession. The 2010 tax act extended specific provisions of the 2009 act through 2012, along with most of the 2001 and 2003 income tax cuts. It also replaced the Making Work Pay credit with a 2 percentage point reduction in the 2011 payroll tax rate for workers.

ECONOMIC STIMULUS ACT OF 2008

The Economic Stimulus Act of 2008 had three main parts: an individual income tax rebate sent in mid-2008 and two business provisions to encourage investment during 2008.

Tax Credits for Individuals

People who filed tax returns for either 2007 or 2008 could qualify for "recovery rebates." In total, the rebates lowered federal taxes by about 5 percent in 2008, reducing the estimated average effective federal tax rate from 19.6 percent to 18.6 percent and cutting federal revenue by nearly $120 billion in fiscal years 2008 and 2009.

Most tax filers received a basic credit of $600—or $1,200 for joint filers—up to their income tax liability before subtraction of child and earned income credits. Tax filers who qualified for less than $300 of the full basic credit ($600 for joint filers) could get $300 ($600 for joint filers) if they had either (1) at least $3,000 in earnings, Social Security benefits, and veteran's payments or (2) net income tax liability of at least $1 and gross income above specified thresholds.

Those thresholds equaled the sum of the applicable basic standard deduction plus one personal exemption (two personal exemptions for a joint return). That value was $8,750 in 2007 ($17,500 for joint filers and $11,250 for heads of household) and $8,950 in 2008 ($17,900 for joint filers and $11,500 for heads of household).

People who qualified for a basic credit could also receive an extra $300 credit for each child eligible for the regular child credit. The act also reduced the sum of the basic and child credits by 5 percent of the tax filer's adjusted gross income over $75,000 ($150,000 for joint filers).

Investment Incentives for Businesses

Two provisions were designed to help businesses:

Some Background

What did the 2008–10 tax stimulus acts do?

1. A one-year doubling of the limitation on expensing depreciable business assets (that is, deducting their full cost in the year the investment was made). This allowed firms to write off up to $250,000, reduced by the amount of qualifying investment over $800,000. After 2008 the limit reverted to $125,000 (indexed from 1997), reduced by the amount of qualifying investment over $500,000 (also indexed from 1997).
2. A "special depreciation allowance for certain property" allowed firms to claim an additional first-year depreciation of 50 percent of the cost of qualifying investments contracted for and placed in service during 2008 (in addition to the amount of investment firms could expense).

The estimated cost of the two provisions over 10 years: $7.5 billion. Specifically, the Joint Committee on Taxation estimated that revenues would drop $51 billion in fiscal 2008 and 2009, offset by $43.5 billion of additional revenue in subsequent years because firms would be unable to depreciate previously expensed investments.

AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

The American Recovery and Reinvestment Act reduced federal taxes by an estimated $287 billion over 10 years. Over 80 percent of the tax cuts—$232 billion—were for individuals; smaller cuts subsidized investment in renewable energy and a handful of provisions for businesses. The Urban-Brookings Tax Policy Center (2009) evaluated each of the act's major provisions, grading them on how large and quick a boost they would give the economy. Provisions that increased households' after-tax income quickly—and thus were most likely to increase spending quickly—received the highest grades. But no provision earned an A.

The "Making Work Pay" Tax Credit

Effective for 2009 and 2010, the Making Work Pay (MWP) tax credit accounted for half of individual tax cuts. The credit equaled 6.2 percent of earned income up to a maximum of $400 ($800 per couple) and phased out at 2 percent of income over $75,000 ($150,000 for couples). As a result, individuals with earnings between about $6,450 and $75,000 (between about $12,900 and $150,000 for couples) could get the maximum credit. Those with incomes exceeding $95,000 ($190,000 for couples) received no credit (Urban-Brookings Tax Policy Center 2009).

A nontax provision extended "economic recovery payments" to certain individuals who did not qualify for the MWP credit. Payments totaling an estimated $14.2 billion went to recipients of Social Security, supplemental security income, railroad retirement benefits, and veterans' disability compensation or pension benefits (Urban-Brookings Tax Policy Center 2009).

The Alternative Minimum Tax Patch

A one-year extension of the alternative minimum tax (AMT) "patch" temporarily raised the AMT exemption. The cost: about $70 billion over 10 years. The patch saved affected taxpayers an estimated average of about $2,400. Under permanent AMT law, roughly 30 million taxpayers would have owed the additional levy (Urban-Brookings Tax Policy Center 2009).

Other Individual Tax Provisions

Other major provisions in the American Recovery and Reinvestment Act replaced the HOPE education credit with the more generous and more refundable American opportunity credit (at a 10-year cost of $14.8 billion), increased the refundability of the child credit ($13.9 billion), boosted the earned income tax credit (EITC—

What did the 2008–10 tax stimulus acts do?

$4.7 billion), and temporarily suspended taxation of the first $2,400 of unemployment benefits ($4.7 billion). All gave taxpayers more money to spend and thus help boost the economy. Two other provisions—the automobile sales tax credit ($1.7 billion) and the homeownership tax credit ($6.6 billion)—subsidized the purchase of cars along with homes for first-time buyers, thus targeting benefits for two industries hit hard by the Great Recession (Urban-Brookings Tax Policy Center 2009).

Business Tax Provisions

A broad range of provisions included incentives for the production of "clean" energy ($20 billion), funding to finance infrastructure development ($19.6 billion), tax benefits for business investment ($8 billion), and other economic recovery tools ($6.5 billion). The largest single provision extended tax incentives to produce electricity from renewable fuels for three years at an estimated cost of $13 billion. Among a variety of infrastructure development tools, school construction bonds ($10 billion), Build America bonds ($4.3 billion), and help for financial institutions ($3.2 billion) provided the most assistance. Special allowances for business investment in 2009 ($6 billion) and provisions related to net operating losses ($3.2 billion) gave additional assistance to firms.

TAX RELIEF UNEMPLOYMENT INSURANCE REAUTHORIZATION AND JOB CREATION ACT OF 2010

Faced with the scheduled sunset of all provisions of the 2001 and 2003 Bush tax cuts and the 2009 stimulus act (as well as several other tax laws), and unable to agree on permanent changes, Congress temporarily extended many provisions in the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010. The law had diverse effects on the tax code:

- It extended all of the 2001 and 2003 individual income tax cuts for two years through 2012.
- It extended selected provisions of the 2009 act for two years through 2012, including
    - the higher EITC phaseout threshold for married couples filing jointly ($5,000 above the threshold for single filers, indexed for inflation);
    - the 45 percent EITC phase-in rate for families with three or more children;
    - the $3,000 threshold (unindexed) for refundability of the child tax credit; and
    - the American Opportunity Tax Credit for higher education.
- It set an effective exemption of $5 million and a 35 percent tax rate for the estate tax for 2011 and 2012, and replaced the state death tax credit with a deduction.
- It reduced the Social Security tax rate on employees to 4.2 percent for 2011 and the self-employment tax rate by 2 percentage points for 2011. (However, the act did not reduce the amount of self-employment tax that taxpayers could deduct on their income tax returns.)
- It raised the AMT exemption to $47,450 for single filers and $72,450 for married couples filing jointly for 2010 and to $48,450 and $74,450, respectively, for 2011.
- It extended other expiring tax provisions, including the deduction for state and local general sales taxes, the above-the-line deduction for education expenses, and the educator expense deduction, through 2011.

Some Background

What did the 2008–10 tax stimulus acts do?

The temporary reduction in the Social Security tax effectively replaced the MWP credit from the 2009 stimulus. That swap reduced the tax savings for low-income workers—single people with earnings under $20,000 and couples with earnings under $40,000—and provided large new tax breaks for high earners. Recall that single workers with income over $95,000 and couples with income over $190,000 got no MWP credit. In contrast, the cut in the Social Security tax rate saved high earners—those with earnings at or above the $106,800 cap on earnings subject to the tax in 2011—$2,136 in payroll taxes and double that for high-earning couples.

A Tax Policy Center analysis showed that, while about two-thirds of households in the lowest income quintile (income under about $18,000) would have gotten either credit, their average MWP credit would have been twice their payroll tax savings—$371 versus $178. Meanwhile, nearly 90 percent of households in the top quintile (income over about $105,000) got an average payroll tax cut of about $2,250, compared with just 60 percent who would have gotten MWP credits averaging about $650.

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Q. What did the American Taxpayer Relief Act of 2012 do?

A. The American Taxpayer Relief Act of 2012 made permanent most of the income tax cuts enacted between 2001 and 2010 and extended other temporary tax provisions for between one and five years.

Numerous tax cuts enacted between 2001 and 2010 were scheduled to expire after 2012, part of the "fiscal cliff" that threatened to cut short nascent recovery from the Great Recession. The expirations involved four tax acts:

- The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) phased in income tax cuts for most taxpayers but scheduled all of the cuts to expire after 2010 to avoid conflict with Senate rules (Joint Committee on Taxation 2001).

- The Jobs and Growth Tax Relief Reconciliation Act of 2003 accelerated the phase-in of some EGTRRA provisions, but retained their expiration dates and lowered tax rates on capital gains and qualifying dividends, also with sunset dates (Joint Committee on Taxation 2003).

- The American Recovery and Reinvestment Tax Act of 2009 (Division B, Title I of the American Recovery and Reinvestment Act, or ARRA) provided a number of temporary tax cuts designed to stimulate the economy, all of which were to sunset by the end of 2010 (Altshuler et al. 2009).

- The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended most provisions of those three acts through 2012 (Urban-Brookings Tax Policy Center 2010).

(Another tax law, the Temporary Payroll Tax Cut Continuation Act of 2011, extended through 2012 a cut in employees' share of the payroll tax funding Social Security, from 6.2 percent to 4.2 percent. The American Taxpayer Relief Act did not extend that provision.)

The Tax Policy Center's analysis of the scheduled expirations found that failure to extend them (including the temporary payroll tax cut) would have raised taxes by more than $500 billion in 2013—an average of almost $3,500 per household. Roughly 90 percent of Americans would have seen their tax bills rise (Williams et al. 2012).

Congress passed the American Taxpayer Relief Act of 2012 (ATRA) early on January 1, 2013, to prevent most of the sunsetting tax cuts from expiring. Most 2001 and 2003 income tax cuts were made permanent for all but the highest-income taxpayers. ATRA extended three ARRA provisions through 2017, while permanent changes to the estate tax and the alternative minimum tax reduced the number of people affected and indexed those provisions for inflation.

Some Background

What did the American Taxpayer Relief Act of 2012 do?

TAX PROVISIONS MADE PERMANENT

Income Tax Provisions

- *Tax Rates*: ATRA maintained the basic marginal tax rate structure of 10, 15, 25, 28, 33, and 35 percent for taxable income under $400,000 ($450,000 for married taxpayers filing jointly); the thresholds were indexed for inflation after 2013. Taxpayers with taxable income above the thresholds face a 39.6 percent marginal tax rate.
- *Pease and PEP:* The limitation on itemized deductions (Pease) and the personal exemption phaseout (PEP) applies only to taxpayers with adjusted gross incomes of $250,000 or more ($300,000 for married taxpayers filing jointly); the thresholds are indexed for inflation after 2013.
- *Child Credits*: The child tax credit equals $1,000 per child and is refundable up to 15 percent of earnings above $10,000 (indexed for inflation after 2001). Another ATRA provision temporarily reduced the refundability threshold to $3,000. The child and dependent tax care credit rate begins at 35 percent on eligible expenses up to $3,000 per child (to a maximum of $6,000) and phases down to 20 percent between adjusted gross incomes of $15,000 and $43,000.
- *Marriage Penalty*: The standard deduction and the 10 percent and 15 percent brackets for joint filers equal twice those for single filers. (ATRA also temporarily extended the higher earned income tax credit phaseout threshold for joint filers.)
- *Education Tax*: ATRA maintained higher annual contribution limits for Coverdell education savings accounts and higher phaseout ranges for the student loan interest deduction.
- *Capital Gains and Dividends:* ATRA retained 15 percent tax rates on long-term capital gains and qualified dividends (0 percent for those who would otherwise be in the bottom two tax brackets) for taxpayers in all but the top income tax bracket; the law also sets a 20 percent rate for those in the top bracket.
- *Alternative Minimum Tax*: ATRA set the 2012 alternative minimum tax exemption at $50,600 ($78,750 for married taxpayers filing jointly) and indexes the exemption amount, the exemption phaseout threshold, and the future tax brackets for inflation.

The "Making Work Pay" Tax Credit

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What did the American Taxpayer Relief Act of 2012 do?

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Some Background

What did the American Taxpayer Relief Act of 2012 do?

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Q. How did the Tax Cuts and Jobs Act change personal taxes?

A. The Tax Cuts and Jobs Act made significant changes to individual income taxes and the estate tax. Almost all these provisions expire after 2025, while most business provisions are permanent.

The new tax law made substantial changes to the tax rates and the tax base for the individual income tax. The major provisions follow, excluding those that only affect business income.

TAX RATES AND TAX BRACKETS

The Tax Cuts and Jobs Act (TCJA) reduced statutory tax rates at almost all levels of taxable income and shifted the thresholds for several income tax brackets (table 1). As under prior law, the tax brackets are indexed for inflation but using a different inflation index (see below).

TABLE 1

Individual Income Tax Brackets and Rates

2018

Prior Law					Tax Cuts and Jobs Act				
Taxable Income ($)				Tax Rate (percent)	Taxable Income ($)				Tax Rate (percent)
Single Filers		Married Couples Filing Jointly			Single Filers		Married Couples Filing Jointly		
Over	But not over	Over	But not over		Over	But not over	Over	But not over	
0	9,525	0	19,050	10	0	9,525	0	19,050	10
9,525	38,700	19,050	77,400	15	9,525	38,700	19,050	77,400	12
38,700	93,700	77,400	156,150	25	38,700	82,500	77,400	165,000	22
93,700	195,450	156,150	237,950	28	82,500	157,500	165,000	315,000	24
195,450	424,950	237,950	424,950	33	157,500	200,000	315,000	400,000	32
424,950	426,700	424,950	480,050	35	200,000	500,000	400,000	600,000	35
426,700	and over	480,050	and over	39.6	500,000	and over	600,000	and over	37

Source: Gale et al. (2018)

Some Background

How did the Tax Cuts and Jobs Act change personal taxes?

FAMILY BENEFITS (PERSONAL EXEMPTIONS, CHILD CREDIT)

TCJA repealed personal and dependent exemptions. In place of personal exemptions, TCJA increased the standard deduction, discussed below. In place of dependent exemptions, TCJA increased the child tax credit (CTC) and created a new $500 tax credit for dependents not eligible for the child tax credit (table 2).

TCJA expanded the CTC in several ways. It doubled the maximum per child credit amount from $1,000 to $2,000 starting in 2018. It also increased the refundable portion of the credit but limited the maximum refundable credit to $1,400 per child in 2018. The maximum refundable amount limit is indexed for inflation but the maximum total credit amount is not. Unlike prior law, TCJA limited eligibility for the credit to children who have a valid social security number.

TCJA extended the CTC to higher-income families by substantially increasing the income thresholds at which the credit phases out. As under prior law, the income phaseout thresholds are not indexed for inflation.

TCJA created a new nonrefundable $500 credit for other dependents, including children who are too old to be eligible for the CTC, full-time college students, other adult members of the household for whom the taxpayer provides significant financial support, and children who would otherwise be eligible for the $2,000 child tax credit but lack a valid social security number. The $500 amount is also not indexed for inflation.

TABLE 2

Family Benefits

Prior Law	Tax Cuts and Jobs Act
Personal and dependent exemptions	
$4,150; indexed for inflation	Repealed
Child tax credit	
$1,000 per qualifying child under 17; phases out at AGI above $75,000 (single), $110,000 (joint); refundable portion equals 15 percent of earnings in excess of $3,000	$2,000 per qualifying child under 17, $500 for other dependents; phases out at AGI above $200,000 (single), $400,000 (joint); refundable portion equals 15 percent of earnings in excess of $2,500 up to a maximum credit of $1,400 per qualifying child; maximum refundable portion indexed for inflation; requires valid social security number

Source: Gale et al. (2018)

AGI = adjusted gross income

STANDARD AND ITEMIZED DEDUCTIONS

TCJA nearly doubled the standard deduction (table 3). As before, the standard deduction amounts are indexed for inflation. The larger standard deductions will substantially reduce the number of taxpayers choosing to itemize their deductions.

Some Background

How did the Tax Cuts and Jobs Act change personal taxes?

TCJA changed the structure of several major itemized deductions. Under prior law, itemizers could claim deductions for all state and local property taxes and the greater of income or sales taxes (subject to overall limits on itemized deductions). TCJA limited the itemized deduction for total state and local taxes to $10,000 annually, for both single and joint filers, and did not index that limit for inflation. As under prior law, taxpayers cannot claim a deduction for state and local taxes against the alternative minimum tax (AMT).

Under prior law, taxpayers could deduct interest on mortgage payments associated with the first $1 million of principal paid on debt incurred to purchase (or substantially renovate) a primary and secondary residence plus the first $100,000 in home equity debt. For taxpayers taking new mortgages after the effective date, TCJA limited the deductibility to the interest on the first $750,000 of loan principal and eliminated the deductibility of interest for home equity debt.

Previously, taxpayers could deduct out-of-pocket medical expenses (including costs for health insurance) above 10 percent of adjusted gross income (AGI). For 2017 and 2018, TCJA allowed deductions for out-of-pocket medical expenses above 7.5 percent of AGI. After 2018, the prior law 10 percent of AGI threshold applies.

TCJA repealed the phase-down of the amount of allowable itemized deductions (sometimes called the Pease provision). This limitation took effect at AGI above $266,700 for single filers and $320,000 for taxpayers filing joint returns.

Some Background

How did the Tax Cuts and Jobs Act change personal taxes?

TABLE 3

Standard and Itemized Deductions

Prior Law	Tax Cuts and Jobs Act
Standard deduction	
$6,500 (single), $13,000 (joint), $9,550 (head of household); indexed for inflation	$12,000 (single), $24,000 (joint), $18,000 (head of household); indexed for inflation
State and local tax deduction	
Real estate, personal property, and either income or sales taxes are deductible	Real estate, personal property, and either income or sales taxes are deductible; total deduction capped at $10,000
Mortgage interest deduction	
Interest payments on up to $1.1 million of debt (including $100,000 of home equity debt) are deductible; applicable to principal and one other residence	Interest payments on up to $750,000 of new acquisition debt are deductible; applicable to principal and one other residence
Medical expense deduction	
Out-of-pocket medical expenses in excess of 10 percent of AGI are deductible	Out-of-pocket medical expenses in excess of 7.5 percent of AGI are deductible in 2017 and 2018; reverts to 10 percent of AGI in 2019
Overall limit on itemized deductions	
Itemized deduction phases out at AGI above $266,700 (single), $320,000 (joint); amounts indexed for inflation	Repealed

Source: Gale et al. (2018)

AGI = adjusted gross income

CAPITAL GAINS, DIVIDENDS, AND THE ALTERNATIVE MINIMUM TAX

TCJA retained the preferential tax rates on long-term capital gains and qualified dividends and the 3.8 percent net investment income tax (NIIT). The NIIT applies to interest, dividends, short- and long-term capital gains, rents and royalties, and passive business income. TCJA separated the tax-rate thresholds for capital gains and dividend income from the tax brackets for ordinary income for taxpayers with higher incomes (table 4).

Some Background

How did the Tax Cuts and Jobs Act change personal taxes?

TCJA retained the individual AMT but raised the exemption levels and raised the income threshold at which the AMT exemption phases out, which will significantly reduce the number of taxpayers subject to the AMT. The exemption amounts and phaseout thresholds continue to be indexed for inflation.

TABLE 4

Capital Gains, Dividends, and the Alternative Minimum Tax

Prior Law	Tax Cuts and Jobs Act
Tax rate on capital gains and qualified dividends	
Zero rate for taxpayers below the 25 percent tax bracket; 15 percent rate for taxpayers in the 25 to 35 tax brackets; 20 percent rate for taxpayers above the 35 percent tax bracket; 3.8 percent NIIT at AGI above $200,000 (single), $250,000 (joint)	Zero rate if taxable income is below $38,600 (single), $77,200 (joint); 15 percent rate if taxable income is between $38,600 and $425,800 (single) $77,200 and $479,000 (joint); indexed for inflation; 3.8 percent NIIT at AGI above $200,000 (single), $250,000 (joint)
Individual Alternative Minimum Tax	
AMT exemption equal to $55,400 (single), $86,200 (joint); phases out at AGI above $123,100 (single), $164,100 (joint); indexed for inflation	AMT exemption equal to $70,300 (single), $109,400 (joint); phases out at AGI above $500,000 (single), $1,000,000 (joint); indexed for inflation

Source: Gale et al. (2018)

AGI = adjusted gross income, AMT = alternative minimum tax, NIIT = net investment income tax

ESTATE TAX

TCJA doubled the estate tax exemption to $11.2 million for single filers and to $22.4 million for couples, and continued to index the exemption levels for inflation (table 5). The top estate tax rate remains at 40 percent.

TABLE 5

Estate Tax

Prior Law	Tax Cuts and Jobs Act
Top rate of 40 percent on estates above $5.6 million (single), $11.2 million (joint); indexed for inflation	Top rate or 40 percent on estates above $11.2 million (single), $22.4 million (joint); indexed for inflation

Source: Gale et al. (2018)

How did the Tax Cuts and Jobs Act change personal taxes?

AFFORDABLE CARE ACT PENALTY TAX

Starting in 2019, TCJA set the Affordable Care Act's (ACA's) individual mandate penalty tax to zero. Previously, households without qualifying health insurance were required to pay a penalty equal to the lesser of 2.5 percent of household income or $695 per adult and $347.50 per child, up to a maximum of $2,085. Under the new law, individuals who do not enroll in adequate health insurance plans will not face a penalty starting in 2019. Because fewer people will obtain free or subsidized coverage in the absence of the penalty tax, and the reduced costs of ACA premium tax credits and other subsidies and Medicaid benefits will far exceed the lost revenue from setting the penalty tax rate to zero, the net effect will be to reduce the federal budget deficit. This provision does not sunset.

INFLATION INDEXING

TCJA changed the measure used for inflation indexing, from the Consumer Price Index for All Urban Consumers (CPI-U) to the chained CPI-U. The chained CPI-U more accurately measures changes in consumer welfare resulting from price changes because it accounts for people finding substitutes for goods whose prices increase faster than others. The chained CPI-U thus generally increases at a slower rate than the traditional CPI-U, implying that individuals will end up in higher tax brackets and that indexed tax credits (like the earned income tax credit) will increase at slower rates than they would have under the old indexing system. The change in indexing is permanent.

SUNSETS

A notable feature of the individual tax and the estate tax provisions is that all of them expire after 2025, except the reduction of the ACA penalty tax, the change in inflation indexing, and several changes in the tax base for business income. Some provisions expire sooner (for example the increased deductibility of medical expenses applies only to tax years 2017 and 2018). In contrast, many of the business tax provisions do not sunset. Congress chose to make the individual provisions temporary to limit the revenue cost of the TCJA to a level consistent with the overall constraint on the 10-year revenue loss in the Congressional Budget Resolution and to comply with Senate budget rules under the process used to pass the tax act that require no increase in the federal budget deficit after the tenth year.

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Data Sources

Congressional Budget Office, "Cost Estimate for the Conference Agreement on H.R. 1, a Bill to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," memo, December 15, 2017.

Joint Committee on Taxation. 2017. "Estimated Budget Effects of the Conference Agreement for H.R. 1, The 'Tax Cuts and Jobs Act." JCX-67-17.

Further Reading

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Some Background

How did the Tax Cuts and Jobs Act change personal taxes?

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Some Background

How did the Tax Cuts and Jobs Act change business taxes?

Q. How did the Tax Cuts and Jobs Act change business taxes?

A. The Tax Cuts and Jobs Act made significant changes to the corporate income tax and taxes on pass-through businesses. Unlike almost all personal tax provisions, which expire after 2025, most corporate tax provisions are permanent.

CORPORATE TAX RATE AND CORPORATE ALTERNATIVE MINIMUM TAX

The Tax Cut and Jobs Act (TCJA) reduced the top corporate income tax rate from 35 percent to 21 percent, bringing the US rate below the average for most other Organisation for Economic Co-operation and Development countries, and eliminated the graduated corporate rate schedule (table 1). TCJA also repealed the corporate alternative minimum tax.

TAX RATES AND TAX BRACKETS

TCJA allowed businesses to deduct the full cost of qualified new investments in the year those investments are made (referred to as 100 percent bonus depreciation or "full expensing") for five years. Bonus depreciation then phases down in 20 percentage point increments beginning in 2023, and is fully eliminated after 2026. Prior law allowed 50 percent bonus depreciation in 2017, decreasing the percentage in subsequent years and fully eliminating it after 2020.

TCJA doubled the Section 179 expensing limit for investments by small businesses from $500,000 to $1,000,000 for qualified property (sometimes called "small business expensing"). It also simplified accounting rules for smaller firms.

TCJA limited the amount of net business interest (interest paid less interest received) that businesses can deduct to 30 percent of business income before interest, depreciation, and amortization. Starting in 2022, the adjustment for amortization and depreciation will be removed from the limitation. Businesses with gross receipts below $25 million are exempt from the limitation. Previously, interest paid was generally fully deductible in computing taxable income for all businesses.

TCJA limited the deduction for net operating losses to 80 percent of taxable income. It also repeals carrybacks of losses, except for certain businesses, but allows taxpayers to carry forward losses indefinitely. Under prior law, net operating losses could offset 100 percent of taxable income and businesses could carry back unused losses for two years or carry them forward for 20 years.

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How did the Tax Cuts and Jobs Act change business taxes?

The new law also eliminated the domestic production activities deduction (Section 199) and modified other smaller provisions such as the orphan drug credit, the deduction for Federal Deposit Insurance Corporation premiums, and the computations for life insurance reserves. In addition, starting in 2022, expenditures for research and experimentation must be amortized over five years (15 years for offshore research and experimentation expenses) instead of being immediately deductible.

TABLE 1

Corporate and Other Business Tax Changes

Prior Law	Tax Cuts and Jobs Act
Top corporate income tax rate	
35 percent	21 percent
Corporate Alternative Minimum Tax	
Yes	Repealed
New investment purchases	
2018: 40 percent bonus depreciation for qualified property; 2019: 30 percent bonus deprecation for qualified property; 2020: 20 percent bonus depreciation for qualified property; small business (section 179) expensing up to $500,000	2018-22: 100 percent bonus depreciation for qualified property; 2023: 80 percent bonus depreciation for qualified property; 2024: 60 percent bonus depreciation for qualified property; 2025: 40 percent bonus depreciation for qualified property; 2026: 20 percent bonus depreciation for qualified property; small business (section 179) expensing up to $1,000,000
Business interest deduction	
Fully deductible (generally)	Disallowed for net interest in excess of 30 percent of business income (excluding depreciation after 2022); exemption for businesses with gross receipts of $25 million or less
Net operating losses	
Fully deductible; unused losses can be carried back for 2 years or carried forward for 20 years	Deduction limited to 80 percent of taxable income; unused losses cannot be carried back but can be carried forward indefinitely

Source: Gale et al. (2018).

PASS-THROUGH BUSINESS INCOME DEDUCTION

Unlike C-corporations, pass-through firms such as sole proprietorships, partnerships, and S-corporations are not subject to the corporate income tax. Instead the owners include their share of profits as taxable income under the individual income tax.

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How did the Tax Cuts and Jobs Act change business taxes?

In general, TCJA's changes to the business income tax base, including the limits on interest deductions and net operating losses, apply to pass-through businesses as well as to business subject to the corporate income tax. However, TCJA included changes specific to pass-through businesses (table 2). The pass-through businesses specific provisions are scheduled to expire after 2025.

TCJA introduced a complex new deduction for income from pass-through businesses. Under the new law, joint tax filers with taxable income below $315,000 ($157,500 for other filers) can deduct 20 percent of their qualified business income (QBI). The 20 percent deduction lowers the effective top individual income tax rate on business income from 37 to 29.6 percent.

If taxable income exceeds those thresholds, however, the deduction can be reduced depending upon the type of business, the wages paid, and the investment property owned by the business. For personal service businesses (such as law firms, medical practices, consulting firms, or professional athletes), QBI phases down on a pro rata basis. Once taxable income reaches $415,000 for joint filers ($207,500 for other filers), QBI is zero and there is no longer any deduction.

For all pass-through businesses, whether they are personal service firms or not, an additional two-part formula limits the deduction once taxable income exceeds the $315,000/$157,000 thresholds. Under the formula, the deduction is limited to the greater of either 50 percent of the wages the business pays its employees or 25 percent of wages plus 2.5 percent of the basis of the business' qualified property. Business owners compare those calculations to 20 percent of their QBI and may deduct only the smaller amount. The limit on the deduction phases in over the same income range as above.

LIMIT ON PASS-THROUGH BUSINESS LOSSES

A major advantage of organizing as a pass-through business rather than as a C-corporation is that pass-through business owners can use business losses to offset taxable income from other sources. TCJA limits the amount of active pass-through business losses that business owners can deduct against other income to $500,000 for joint filers ($250,000 for other filers). Unused losses, however, can be carried forward and used in future years (table 2).

TABLE 2

Tax Changes Specific to Pass-Through Businesses

Prior Law	Tax Cuts and Jobs Act
Income from pass-through businesses	
Taxed at ordinary income rates (maximum rate of 39.6 percent)	Provides 20 percent deduction for qualified business income (maximum rate of 29.6 percent); deduction limited for taxable income above $157,500 (single), $315,000 (joint)
Pass-through business losses	
Active losses fully deductible from other income	Deductible losses limited to $250,000 (single), $500,000 (joint); unused losses can be carried forward

Source: Gale et al. (2018).

Some Background

How did the Tax Cuts and Jobs Act change business taxes?

INTERNATIONAL ISSUES

TCJA made sweeping changes to the treatment of foreign source income and international financial flows. Under prior law, the United States taxed the income of multinational firms on a worldwide basis, meaning that all income was taxed, regardless of where it was earned, less a credit for foreign taxes paid. However, the tax due on active foreign-source income of foreign subsidiaries of US multinationals was deferred until the income was made available to the US parent company.

The TCJA created a modified territorial tax system. US corporations continue to owe US taxes on the profits they earn in the United States. But TCJA exempted from taxation the dividends that domestic corporations receive from foreign corporations in which they own at least a 10 percent stake.

Under a pure territorial system, firms would have a strong incentive to shift real investment and reported income to low-tax jurisdictions overseas and to shift deductions into the United States. Several provisions were created as guardrails to reduce the extent to which companies take those actions.

The minimum tax on global intangible low-taxed income (GILTI) imposed a 10.5 percent minimum tax without deferral on profits earned abroad that exceed a firm's "normal" return (defined in the law as 10 percent on the adjusted basis in tangible property held abroad). Companies can use 80 percent of their foreign tax credits, calculated on a worldwide basis, to offset this minimum tax.

Whereas GILTI acts as a "stick" to prevent companies from making investments in intangible assets overseas, a deduction for foreign-derived intangible income (FDII) acts as a "carrot" to provide an incentive for firms to hold intangible assets in their US affiliates. FDII is income received from exporting products whose intangible assets are held in the United States. For example, a pharmaceutical company will be able to deduct some income from overseas drug sales if the patent on the drug is held in its US parent company.

TCJA also created a new base erosion and antiabuse tax (BEAT), which—not surprisingly, given the acronym—is another "stick." BEAT imposes a minimum tax on otherwise deductible payments between a US corporation and a related foreign subsidiary.

To transition to the new system, TCJA created a new deemed repatriation tax for previously accumulated and untaxed earnings of foreign subsidiaries of US firms equal to 15.5 percent for cash and 8 percent for illiquid assets. In 2015, it was estimated that US companies held more than $2.6 trillion in untaxed income in their foreign affiliates (Barthold 2016). Companies have eight years to pay the tax, with a back-loaded minimum payment schedule specified in the law.

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Data Sources

Congressional Budget Office, "Cost Estimate for the Conference Agreement on H.R. 1, a Bill to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," memo, December 15, 2017.

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Further Reading

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Gale, William G., Hilary Gelfond, Aaron Krupkin, Mark J. Mazur, and Eric Toder. 2018. "Effects of the Tax Cuts and Jobs Act: A Preliminary Analysis." Washington, DC: Urban-Brookings Tax Policy Center.

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