CPA
Practice Advisor

benefits could best be described as modest.

Apr. 11, 2024

President Donald Trump sits at the Resolute Desk during a briefing on Hurricane Michael in the Oval Office of the White House in Washington, D.C., on October 10, 2018. (Saul Loeb/AFP/Getty Images/TNS)

By Karl W. Smith, Bloomberg Opinion (TNS)

Back in 2017, the debate around President Donald Trump's tax cuts was a case study in how quickly a discussion around legitimate policy can descend into partisan nonsense. On one side, Republicans spouted unfounded claims that the tax cuts would pay for themselves. On the other, Democrats spouted equally unfounded claims that only big business and the wealthy would benefit.

As usual, the truth landed somewhere in the middle. No, the Tax Cuts and Jobs Act of

sweeping overhaul the tax system since the Reagan administration. For businesses, it aimed to spur capital spending by slashing the corporate tax from 35% to 21%. For individuals, it lowered rates across the board and simplified the code by limiting itemized deductions, increasing the standard deduction taken by those who don't itemize and expanding access to the child tax credit.

The problem now is that largely because of fiscal spending to support the economy through the pandemic, the federal budget deficit has expanded to 6.44% of gross domestic product from 4.67% at the end of 2019, which at the time was the biggest shortfall since 2013. Also, the cost of servicing the deficit by borrowing has soared along with benchmark interest rates the last two years. For this reason alone, it's possible some, but not all, the cuts will reversed. But which ones? Whatever is decided, the corporate cuts are probably the last thing we want to repeal.

Despite the insistence of Republicans, who point to the rise in federal revenue following 2017, we can't shrink the deficit by further reducing taxes. In 2022, federal revenue came in at $4.9 trillion, far higher than the $4.2 trillion predicted by the bi-partisan Congressional Budget Office before the tax cuts. Two factors are responsible for the outperformance. One, capital gains tax revenue jumped following the stock market's big rally in 2020 and 2021. Two, a worker shortage during the pandemic caused wages to rise by almost 5% over the course of 2021. Higher wages not only led to higher incomes but also pushed many Americans into higher tax brackets, thereby increasing revenue.

Democrats have described the tax cuts as only benefiting the wealthy. This is also a gross distortion of the facts. Between 2017 and 2019, taxpayers at both the bottom and top of the income scale saw their average tax rate decline by a little less than 1%. Those in between saw more significant reductions, with the upper middle class—defined as those making $200,000 to $500,000 a year—seeing their tax rates decline by 2.5%. This reflects the fact that many of them are small business owners who,

businesses would use those higher profits to fund stock buybacks or higher dividend payouts to investors. Indeed, buybacks did increase sharply after 2017. For example, Apple Inc. doubled stock buybacks as its investment in the US declined. That was a bad look, but it doesn't necessarily mean tax cuts didn't work. If there had been none, Apple might have decided to decrease investment even more to fund stock buybacks.

Teasing out precisely what effect the Trump tax cuts had on a particular company's investment decisions requires a deep dive into financial and tax records. Four economists from Harvard University, Princeton University, the University of Chicago and the U.S. Treasury Department conducted a detailed analysis of more than 12,000 companies. The results released last month found that companies which experienced larger increases in their return on investment as a result of the tax cut, boosted their investment spending by larger amounts.

With their results, the economists calculated the effect lower tax rates had on the broad economy. Their estimates show that from 2018 to 2023, the Trump tax cuts raised annual investment by a little more than 7%. That equates to an additional $265 billion in private investment in 2023. They also estimated that increased business investment raised the average worker's wages by about 1%—an income boost roughly equal to what millions of Americans got directly from the tax cuts. Yet, the corporate tax cuts cost $450 billion in the form of decreased federal revenue, compared with $1.1 trillion for individual tax cuts.

The Trump tax cuts were neither an economic panacea nor a rip-off. They produced a modest but meaningful increase in income for working Americans, both by reducing their tax burdens and increasing their wages. Lawmakers should keep this in the front of their minds as they debate how much, if any, of those tax cuts to keep.

This column does not necessarily reflect the opinion of the editorial board or Bloomberg LP

Income Tax • Legislation • Taxes