Effect of the Tax Cuts and Jobs Act on the Income Tax Liabilities of Hypothetical Lynchburg-Area Families

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This report provides illustrations of how the individual income tax liabilities of typical Lynchburg households would be impacted by H.R. 1, The Tax Cuts and Jobs Act, as agreed upon by the conference committee last week. The conference agreement will likely be voted on this week by the House and Senate, and if passed in both houses, signed into law by President Trump who has indicated support for the legislation. The legislation would make changes to both individual and corporate taxes. The bill would also repeal the individual health insurance mandate in the Affordable Care Act and double the estate tax exemption. The Joint Committee on Taxation estimates that the bill would increase the debt by an estimated $1.5 trillion over the next 10 years, although JCT suggest that macroeconomic feedback resulting from the tax reform could lower that figure to $1 trillion.

Key provisions of the legislation on the individual tax side include:

- Lowering of ordinary tax rates from 10%, 15%, 25%, 28%, 33%, 35%, and 39.6% brackets to 10%, 12%, 22%, 24%, 32%, 35%, and 37% brackets
- Increase in the standard deduction (nearly doubling)
- Elimination of personal exemptions
- Creation of a 20% deduction for pass-through business income
- Increase in the child tax credit from $1,000 to $2,000 per child and higher phaseout thresholds from $75,000 (single) and $110,000 (married) to $200,000 (single) and $400,000 (married)
- Creation of a $500 non-refundable credit for non-children dependents
- Implementation of a $10,000 cap on the deduction for state and local taxes paid
- Lowering of the maximum mortgage amount on which interest can be deducted to $750,000
- Increased AMT exemption
- Chained CPI inflation adjustment instead of CPI-U, thereby slowing annual inflation adjustments

Key provisions on the corporate side include:

- Decrease in the U.S. corporate tax rate from 35% to 21%
- Move U.S. international tax system from a worldwide system of taxation to a territorial system and impose a one-time deemed repatriation tax on overseas earnings
- Friendlier depreciation treatment, including expansion of expensing
- Restrictions on interest deductibility for corporations

Most of the individual income tax provisions in the legislation would expire following tax year 2025, while many corporate provisions such as the corporate rate cut are permanent. Of course, a future Congress could change the timing of any provisions in the law.

The bill text, descriptions of proposals, and a preliminary JCT score are available here: http://docs.house.gov/billsthisweek/20171218/CRPT-115HRPT-466.pdf.

Hypothetical Lynchburg Families

Table 1 below shows how seven hypothetical Lynchburg families would see their 2018 individual income tax liabilities change because of the proposed tax reform legislation. These hypothetical families were created based on Census Bureau data and do not reflect every possible scenario. The income amounts were based on median family/household income for the Lynchburg MSA for that family type.

The figures show all seven hypothetical family types getting a tax cut in 2018. This is consistent with the finding from other organizations showing that an overwhelming majority would receive a tax cut in 2018 from this legislation. Those most likely to face a tax increase are those currently itemizing, living in high-tax states, and making over $100,000, which is not common in Lynchburg. When looking at future years, however, the tax reductions are likely to be smaller than those in the table. And if the reform expires in 2025 as scheduled, most families would actually face a tax increase in 2026 relative to current 2026 law.

Table 1: Hypothetical Families' 2018 Income Tax Liabilities (pre and post-H.R. 1 conference agreement)

Unit Type	**Number of Children (under 17)**	**Income by Source and Itemized Deductions (if any)**	**Income Tax in 2018 Current Law**	**Income Tax in 2018 Tax Reform**	**Change in 2018 Tax Liability**
Single Earner	0	$30,000 (wages only)	$2,426.25	$1,969.50	- $456.75
Single Mother	1	$25,000 (wages only)	- $2,746.26	- $3,761.26	- $1,015
Married Couple	0	$69,000 (wages only)	$6,202.50	$5,019	- $1,183.50
Married Couple	2	$80,000 (wages only) $5,000 in S&L taxes $5,500 in interest paid $3,000 in charity	$4,532.50	$2,339	- $2,193.50
Married Couple (2x median)	0	$138,000 (wages only) $11,000 in S&L taxes $5,000 in interest paid $7,000 in charity	$17,982.50	$16,959	- $1,023.50
Married Couple (Elderly/Retired)	0	$55,000 ($27,000 in social security + $24,000 in retirement + $1,000 in interest + $3,000 in qualified dividends)	$585	$315	- $270
Married Couple (Business Owner)	1	$100,000 ($62,000 in sole prop income + $38,000 in wages) $7,000 in S&L taxes $6,000 in interest paid $5,000 in charity	$8,480	$5,251	- $3,229

As Table 1 shows, the biggest winners from the tax reform are families with children and the business owner. Families with children benefit because the (nearly) doubling of the standard deduction and the doubling of the child tax credit ($1,000 per child to $2,000 per child) more than offset the loss of the repeal from the personal exemption. The business owner benefits because he/she is allowed a new deduction of 20 percent of qualified business income, which we assume in this example applies to the entire $62,000 in sole proprietor income.

The benefit from the lower tax rates apply to all the hypothetical families in the table above. The parameters chosen for the high-income family ($138,000 with certain itemized deductions) lead to it not receiving a large tax reduction relative to families with lower incomes. This is because in this example the family has no children and the itemized deduction total is $23,000, which is slightly below the new standard deduction amount of $24,000. This family would lose the personal exemption but not gain much from the increase in the standard deduction because they are already claiming $23,000 in deductions. If this high-income family had two children, its tax savings from the tax reform would be $2,348.50 instead of $1,023.50 because the new law doubles the child tax credit and markedly increases the phaseout thresholds. Under current law, a married family with children making $138,000 would have some or all of its child tax credit eliminated, depending on the number of qualifying children it claimed. Under the tax reform, a family earning $138,000 would not have its child tax credit phased out at all.

The elderly couple benefits the least because their current tax liability is so low, and they have no children or earnings that gives them refundable tax credits. They do benefit slightly from the increased standard deduction. It should be noted that the tax legislation in conference preserves the extra standard deduction available to the blind and elderly. It also preserves the preferential tax treatment of capital gains and qualified dividends, the latter of which we assume the retired couple had.

The single mother benefits somewhat as her individual income tax liability is reduced due to the increase of the child tax credit from $1,000 per child to $2,000 per child. The proposed legislation allows for a higher refundable portion of the child tax credit – up to $1,400 per child can be refundable, which means exceeds one's income tax before credits. The reason this hypothetical taxpayer has a negative tax liability in the first place is due to the combination of two refundable credits: the additional child tax credit and the earned income tax credit.

Finally, the single earner receives a modest tax break as he/she benefits from the increase in the standard deduction and lower second bracket (12% instead of 15%). This earner will only be taxed on $18,000 of his $30,000 in income as opposed to the current $19,350 thanks to the increase in the standard deduction more than offsetting his/her loss of one personal exemption. And he/she will only pay 12% tax on this taxable income instead of the previous 15%.

Methodology

The figures reported here are calculated as follows.

First, we use American Community Survey data from the Census Bureau for the Lynchburg Metropolitan Statistical Area to obtain the median income of various family and household types.

Second, we make assumptions about the key deductions that typical taxpayers with those income and household types typically make, and an estimate of the typical state and local taxes paid by a Lynchburg family (Virginia income tax, local real estate tax, and personal property taxes). It is assumed that retirement income and interest is taxable.

Third, we calculate the individual income tax liability for each hypothetical family under scheduled 2018 current law (i.e., assuming the tax reform does not pass).

Fourth, we calculate the individual income tax liability for each hypothetical family assuming H.R. 1 is enacted as agreed upon by the conference committee.

The figures reported here are for tax year 2018. It should be noted that due to the smaller annual inflation adjustments, taxpayers will likely see smaller tax savings in the later years.

We ignore the legislation's estate tax changes, corporate tax changes, and repeal of the individual health insurance mandate.

The tax estimates above only account for federal individual income taxes.

Media interested in other hypothetical examples are welcome to contact the authors.

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