Assignment 2: Tax Cuts and Jobs Act

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The Tax Cuts and Jobs Act

In 2017, the Tax Cuts and Jobs Act became a law, which represented an essential overhaul of tax code for more than three decades. TCJA bought reforms that reduced rates of statutory tax of taxable income and changed the threshold for various tax brackets. In the prior tax laws, tax brackets are subjected to inflation using various inflation indexes. Since when the act was signed into law, valuable resources have been published by the Tax Foundation to help people understand what the TCJA changed, and how the US economy will be impacted. The paper analyzes the impact of Tax Cuts and Jobs Act on individual taxpayers, and the related tax planning strategies.

**The Purpose and Objective for the Implementation of the Tax Cuts and Jobs Act**

The administration of President Trump achieved one of its primary goals through the implementation of a comprehensive tax reform act in over 30 years. The purpose of the Tax Cuts and Jobs Act (TCJA) is to bring tax reduction to families with low and middle incomes in the US and make businesses in the US more competitive. The TCJA changed income tax for individuals, which includes some of the reforms to the itemized deductions and minimum tax and child tax credit and marginal tax rates (York, 1). The objective for implementation was to simplify income tax for households by adopting the new standard deductions, rather than itemizing different deductions and reducing the cost of compliance. The TCJA simplified the process of filing taxes, which translated reduced time wasted by households in filling returns, and real cost saving in the US economy.

**Significant Changes Brought Forth by the Tax Cuts and Jobs Act**

***Lowering the rate of corporate tax***

The TCJA introduced a permanent reduction of the federal corporate tax rate by 14%, which was active from December 2017. Corporations offering personalized services such as legal services, accounting, and health services were put in the same bracket of taxation with government corporations, which converted progressive income tax rates into a flat tax rate (York, 1).

*Advantages*

* The reduction in corporate tax rate benefitted workers because productivity will be boosted, and wages in the economy will grow.
* New investments will increase the size of their capital, productivity will grow, and employment will increase in the economy.

*Disadvantages*

* The US government will lose tax revenue, which may affect the development agenda of the federal government.
* The reduction of corporate tax benefitted wealthy shareholders rather than workers (York, 1).

***Pass-through income deductions***

The TCJA adopted the reduction of tax rates that is applicable to individuals’ ordinary income. The top marginal rate dropped from 39.6% to 37%. The legislation allowed a 20% deduction of taxes, but subject to limitations (Tax Policy Center, 2).

*Advantages*

* Reduced the chances of double taxation which happens when corporations when dividends are taxed in corporate and shareholder levels
* Reducing the marginal individual tax rates encourages people to start new businesses (independent contractors) because individual employers are taxed lowly (Tax Policy Center, 2).

*Disadvantages*

* The pass-through deduction provided tax breaks for independent employers (contractors) and not the employees.
* The changes could encourage firms to have arrangements that can remove workers from direct employment, which will lead to lower wages and benefits to the affected employees (Tax Policy Center, 2).

***Interest deductibility***

The TCJA modified the IR code that limited the deduction of interest from businesses to 30% of the taxable income, but subject to various restrictions for the tax year that began in December 2017. Some taxpayers were excluded from this limitation, which includes corporations will annual revenue of less than $25 million, public utilities that are regulated, and farming businesses (Hunt, 3).

*Advantages*

* Helps businesses to improve their revenue and profits through interest rate reduction
* Increased business productivity, growth of wages, and economic growth

*Disadvantages*

* Corporates lending money to businesses will lose interest in revenue, which in turn will reduce government revenue.
* The limitation that was adopted in the interest deductibility made acquisitions through debt financing less attractive, but the reduction of federal corporate tax would alleviate this problem (Hunt, 3).

**Impact of Each Change on Taxpayer**

***Lowering the rate of corporate tax***

Reducing the corporate tax rate will benefit the taxpayer as an individual because it will lead to wage growth for the employees. Also, more jobs will be created in corporations, which will benefit taxpayers. Families will benefit from increased wages and high employment through improved standards of living when corporate taxes are reduced (Watson, 4).

***Pass-through income***

Pass-through income deduction will impact an individual taxpayer by reducing the chances of double taxation that may happen in their dividends and their income. Eliminating double taxation will improve the revenue generated by the individual taxpayer. As a family, pass-through income deduction will improve standards of living because many families will be encouraged to start new investments due to high tax incentives provided in the pass-through income deductions changes in the TCJA (Watson, 4).

***Interest deductibility***

Changes related to interest deductibility will benefit individual taxpayers through increased wages. When inters on businesses is lowered, employees’ wages are likely to increase, which will improve the living conditions of individual taxpayers and that of their family (Hunt, 3).

**Recommended Tax Planning Strategies to Maximize Tax Savings**

First, corporations can be recommended to engage in investment activities that can produce income that is exempted from taxation. Some of the investments include domestic production, and orphan drug credits, which enjoy high tax reduction; thus, helping organizations to save on taxes. Secondly, in pass-through deduction, employees are advised to start their independent contracting firms, such as plumbing, electrical firms, and masonry, which enjoy high tax breaks, thus enabling employees to enjoy high savings on taxes (Watson, 4). Finally, in interest deductibility, businesses can defer certain tax liabilities through investing in choices that incur low tax liabilities such as pension plans and contributions. Also, businesses can invest in mortgage loans that attract low tax and inter rates.

Sources

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