GOP Faces Challenge With Tax Overhaul: How to Treat the Rich – Update

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Washington – Republicans, long champions of tax cuts, face a conflict about how to treat the rich in a tax overhaul.

President Donald Trump has said the tax overhaul won't benefit the wealthy, including himself. Republicans have jettisoned some tax cuts they have long supported for high-income households, leaving tax rates on capital gains and dividends untouched, showing an openness to keep the top tax rate for individuals near its present level of 39.6%, and proposing to cut deductions on state and local taxes that could leave some wealthy households paying more.

However, the top 1% of households would reap significant tax cuts from the plan in other ways, including the proposed repeal of the estate tax, the elimination of the alternative minimum tax, and lower tax rates on corporations and businesses that pay taxes through their owners' individual tax returns.

That has made the Republican tax plan's effects on the wealthy a target from both the left and the right, with Democrats calling it a giveaway to the rich and some conservatives warning that Republicans are forgoing economic growth in the name of avoiding political attacks.

There are benefits for the middle class, too, but they are less specific and subject to change because of details Republicans haven't announced yet. Many households, especially in the upper middle class, may end up experiencing tax increases because the loss of tax breaks would outweigh cuts in tax rates.

The top 1% of households would get an average tax cut of $129,030 in 2018, boosting their after-tax incomes by 8.5% and lowering the share of U.S. taxes they would pay, according to an analysis released Friday by the Tax Policy Center. Overall, Americans would get a 2.1% increase in after-tax income.

"The top income groups will receive the biggest tax cuts," said Eric Toder, co-director of the center.

That analysis includes assumptions about details that Republicans haven't specified yet, including the income thresholds where the tax brackets hit and the size of the child tax credit. Those decisions will shape the impact of the plan. Under Friday's assumptions, the plan would raise taxes on 12.2% of households in 2018, with the biggest concentration of losers in the upper middle class.

Among Americans in the top fifth of the income distribution, 32% would see a tax increase, according to the analysis. Among the top 1%, 10.7% would see a tax increase.

That is in part because of the elimination of the state and local tax deduction and personal exemptions. Households in the bottom half of the income scale -- who often pay payroll taxes used to fund Social Security and Medicare but little or no income tax -- would get average tax cuts under $1,000.

The center's analysis says the plan would cut taxes by $2.4 trillion over a decade, in line with other estimates. Republicans are aiming for a $1.5 trillion tax cut over a decade. The Tax Policy Center analysis leaves out revenue-raising provisions that are vague in the GOP plan, including unspecified limits on business and individual tax breaks.

Republicans have been conflicted over how to tax high-income households. Economically, they argue that cutting top marginal income-tax rates has the biggest benefit, creating greater incentives for people to work, save and invest.

"It is the highest rates that cause the most damage," said Chris Edwards of the libertarian Cato Institute. "Flatter tax rates, flatter tax structures are more efficient, period."

Politically, tax cuts at the top are unpopular. In a Wall Street Journal/NBC News poll this month, just 12% of Americans said they wanted to cut taxes on the wealthy, while 62% favored higher taxes on that group. That is a point Mr. Trump's speeches reflect.

"Our framework includes our explicit commitment that tax reform will protect low-income and middle-income households, not the wealthy and well-connected," Mr. Trump said. "They can call me all they want. It's not going to help. I'm doing the right thing, and it's not good for me. Believe me."

The heirs of Mr. Trump, who says his net worth exceeds $10 billion, would benefit from estate tax repeal. The president, as the owner of numerous pass-through businesses, would also likely gain from the 25% top rate on those firms, down from 39.6% presently. Unlike past presidents, Mr. Trump has refused to release his tax returns, making even a rough calculation challenging. Still, the Republican plan doesn't reflect all of the party's desires to cut taxes affecting high-income households.

Just six months ago, Republicans argued for a retroactive tax cut on capital gains and dividends, as a way of repealing a 3.8% investment income tax created in the 2010 Affordable Care Act. That levy only affects individuals with income over $200,000 and married couples with income over $250,000. The House GOP tax plan from last year called for taxing capital gains, dividends and interest at half of ordinary income-tax rates.

The tax framework unveiled on Wednesday mentioned none of that.

"You just can't do everything you want to do," said House Speaker Paul Ryan (R., Wis.), who blamed a lack of "fiscal space" and the Senate's inability to pass a health-care bill.

Instead, Republicans focused the framework on business tax cuts in a bid to boost investment and compete with other countries. They proposed lowering the corporate tax rate to 20% from 35% and reducing the top tax rate to 25% from 39.6% on businesses that pay taxes on their owners' individual returns. And they would allow companies to write off investments immediately for five years.

They also showed flexibility on the top individual rate for wage-earners, setting it at 35% but then leaving themselves room to set a fourth bracket above that so they can meet a goal of making the rich bear as much of the tax burden as they do now.

They are likely to exclude estate tax repeal from that calculation. That tax applies only to estates worth about $5.5 million for individuals and almost $11 million for married couples. Republicans argue that workers, not shareholders, will benefit most from business tax cuts because lower rates will promote hiring and investment.

Treasury Secretary Steven Mnuchin has said more than 70% of the corporate tax is borne by workers through its effects on hiring and wages. That is much more than estimated by many economists, including those at the Congressional Budget Office, the Joint Committee on Taxation and the Treasury Department's own staff, according to a technical paper the Treasury recently removed from its website. Their estimates show that 18% to 30% of the corporate tax is borne by workers.

Democrats have been almost universally opposed to the GOP plans, saying they should start from the premise of not cutting taxes at the top.

"Don't call it reform, because it is not reform," said House Minority Leader Nancy Pelosi (D., Calif.). "It's just more of the same trickle-down economics that want hardworking middle class families to pay more. And we say, not one penny more in deficit-exploding tax breaks for the wealthiest in our country."