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Proposed Changes to Federal Income Tax Law Under the Trump Plan and the Effect on New York City Taxpayers

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Overview

During his campaign, President Trump outlined plans for sweeping changes to the Federal individual tax code with the stated intention of providing tax cuts to every household in the nation. The New York City Comptroller's Office has conducted an analysis of the proposal, examining more than 365,000 income tax records for City tax filers to understand how Trump's tax plan affects New Yorkers' bottom lines.

Among its key features, the proposed tax plan:

- Reduces existing tax brackets from seven to three, eliminating the Head of Household Filing Status and broadening tax brackets.
- Reduces the top marginal income tax rate for ordinary income from 39.6 percent to 33 percent.
- Increases the standard deduction for single filers from $6,300 to $15,000, and from $12,600 to $30,000 for married filers. Because the Head of Household filing status is eliminated, those filers would receive the same deduction as single filers.
- Eliminates personal exemptions.
- Repeals the Alternative Minimum Tax (AMT) and taxes carried interest as ordinary income.
- Limits itemized deductions to $100,000 for single filers and $200,000 for married joint filers.
- Allows above-the-line exclusions for child care costs up to the statewide average cost for four children and further provides an expanded EITC credit for low income households.
- Repeals the additional 3.8 percent tax rate on investment income and the 0.9 percent surcharge on wage income that were imposed on high-income filers as part of the Affordable Care Act (ACA). [1]

The analysis found the plan disproportionately benefits the highest-income earners, while providing most moderate- and middle-income earners with only modest benefits – and in many cases, even tax increases relative to current law. The review found:

- More than one-third of moderate- and middle-income families would see tax <u>increases</u> – while the highest earners in New York City would benefit the most.
- The wealthier the New Yorker, the higher the benefit. Generally, the plan provides high income filers (with Federal adjusted gross income (AGI) in excess of $500,000) with

[1] Even though the House failed to pass the replacement to the ACA, the analysis assumes that the Trump Plan will continue to phase out the taxes imposed by the ACA mainly on high income filers.

significant tax reductions through lower marginal tax rate cuts on ordinary and capital gains income and the elimination of the AMT.

- Among moderate-income families, single parents specifically would face significant tax increases, if the “Head of Household” filing status is eliminated.
- Nearly half of single filers with incomes between $100,000 and $500,000 also stand to lose under the proposed plan.
- More than one-third of filers with income between $50,000 and $250,000 would be worse off under the proposed plan.
- The overall plan would provide tax cuts to NYC residents in excess of $5 billion annually, but almost two-thirds of the cuts would go to filers making more than $500,000.
- While the majority of residents would see a very modest decrease in liability, the potential funding cuts to New York City in order to pay for the overall tax plan could be significant.
- The estimated cost over a ten year period to the Federal Government of the Trump income tax proposal ranges from $2.2 trillion to $3.3 trillion[2]. In order to pay for it – as well as significantly higher military spending, a potential border wall, and other projects – President Trump will likely propose cuts in federal aid to state and local governments.
- As such, whatever modest tax benefit middle-income New Yorkers might receive would likely be offset by declining quality of life due to cuts to social services and other programs.

As laid out on President Trump’s campaign website, the plan leaves out many technical details and compliance measures, particularly regarding the childcare tax credit.[3] The framework of the proposed Trump plan, however, is similar to a proposal that House Speaker Paul Ryan introduced earlier this year. Some version of the plan therefore likely carries significant support in the Republican-controlled Congress.

In addition to the individual income tax proposal, President Trump has also championed a significant reduction in the corporate income tax rate from the current 35 percent to 15 percent. This proposal would also likely result in a reduction in the tax rate on business income that unincorporated filers pay. For federal purposes, this is reported as pass-through income on personal income tax forms. Details on the full extent of taxation of pass-thorough income are lacking, so this aspect of the proposal is treated separately in the following analysis.

[2] Tax Policy Center (Urban Institute and Brookings Institution) 2016 and Tax Foundation 2016.

[3] The plan was originally accessed at https://www.donaldjtrump.com/policies/tax-plan. The website has subsequently been taken down.

General Considerations on the Proposed Plan

As designed, the plan includes a mix of tax raising and tax reduction measures that impact filers differently depending on their income level and filing status.

Generally, the plan provides high income filers (with Federal AGI in excess of $500,000) with significant tax reductions through lower marginal tax rates on ordinary and capital gains income and the elimination of the AMT. These reductions are offset to some degree by the limitation on itemized deductions and the elimination of the preferential treatment for carried interest. The other provisions of the plan have no or minimal impact on these filers. The elimination of personal exemptions has no effect on these filers because of existing limitations that already phase out personal exemptions starting at $259,000 for single filers and $311,000 for married filers. Since almost all high income filers itemize their returns, the higher proposed standard deductions also has no significant impact on these filers.[4] In addition to the tax provisions outlined in the previous section, the proposal to reduce the tax rate on business income taxes, if implemented, could also largely benefit high-income filers with significant amounts of pass-through business income.

For low- to middle-income filers, the interaction of these provisions — and whether taxpayers end up in a better position under the Trump plan — is far less straightforward, depending on many potentially opposing factors. Lower income Head of Household filers, generally single parents, and single filers will face higher marginal tax rates. As shown in the table below, a Head of Household filer would face a marginal income tax rate of 25 percent on income greater than $37,500 under the Trump Proposal — compared to only 15 percent under current law.

Additionally, the elimination of personal exemptions increases taxable income by $4,050 for each exemption compared to current law. This increase can be mitigated by the proposed higher standard deduction and childcare credits, but only to the extent that filers have children (singles do not benefit from this provision) and provided they take the standard deduction as opposed to itemizing deductions on their returns.

The net effect of the Trump proposals varies considerably for most filers, and needs to take into account individual filer characteristics.

[4] The limitation on itemized deductions for high income filers is also partly mitigated by existing limitations imposed by current law through the AMT and the so called Pease limitation. However, the proposed Trump plan imposes much stricter limits than current law.

Impact on New York City Households: Methodology

We used a dataset of more than 365,000 income tax records for NYC tax filers to analyze the interaction and net effect of these proposed changes as they relate specifically to the income and household characteristics of New York City residents. Each of the income tax records are assigned a weight that is designed to represent and replicate the liability of NYC's overall tax filing population.

Proposed Trump Plan: Marginal Tax Rates on Ordinary Income by Filing Type and Income Bracket

Marginal Tax Rate	Head of Household	Singles	Married Joint
12.0%	$0 to $37,500	$0 to $37,500	$0 to $75,000
25.0%	$37,500 to $112,500	$37,500 to $112,500	$ 75,000 to $225,000
33.0%	$112,500+	$112,500+	$225,000

Current Law: Marginal Tax Rates on Ordinary Income by Filing Type and Income Bracket

Marginal Tax Rate	Head of Household	Singles	Married Joint
10.0%	$0 to $13,250	$0 to $9,275	$ 0 to $18,550
15.0%	$13,250 to $50,400	$9,275 to $37,650	$18,550 to $75,300
25.0%	$50,400 to $130,150	$37,650 to $91,150	$75,300 to $151,900
28.0%	$130,150 to $210,800	$91,150 to $190,150	$151,900 to $231,450
33.0%	$210,800 to $413,350	$190,150 to $413,350	$231,450 to $413,350
35.0%	$413,350 to $441,000	$413,350 to $415,050	$413,350 to $466,950
39.6%	$441,000 +	$415,050+	$466,960+

This dataset provides information on key federal income tax parameters such as capital gains and ordinary income, the number of exemptions, itemized deductions, and other tax parameters for each of the sampled filers. By changing these parameters to reflect the proposed law, the effects of the proposed plan on federal income tax liability can be simulated and compared to the existing liability under current law. This comparison determines who faces lower taxes and higher after-tax income under the Trump plan (winners) and who instead faces a higher tax bill and lower after-tax income under the plan (losers).

We examined the impact on households in six different income brackets and for three filing types. By examining different ranges of income and household characteristics, this detailed analysis allows one to gauge which households stand to benefit most from the proposed plan and whether the plan lives up to its goal of providing tax relief to all households.

The results of this simulation are shown in the accompanying tables. Key highlights of the proposed changes are summarized below.[5]

Key Results

The wealthiest New Yorkers stand to gain from Trump Plan

Taxpayers with incomes above $500,000 are the main beneficiaries under the Trump Plan for all filing types.

For filers with income above $500,000, lower marginal tax rates on ordinary and capital gains income and the elimination of the AMT generally result in lower taxes. These filers stand to lose only if the offsetting effect from the limitation in itemized deductions ($100,000 for singles and $200,000 for married couples) is very large.

As shown in the chart below, almost 96 percent of filers with AGI between $500,000 and $1 million and 92 percent with income above $1 million would pay less in taxes. Their median after-tax disposable income is expected to increase by more than 6 percent.

In addition, high income filers also stand to benefit from proposed reductions in the corporate income tax rate from 35 percent to 15 percent that would also likely apply to unincorporated business income. For federal purposes, this business income is taxed on the individual tax form as pass-through income. As shown on the following page, if these corporate income tax provisions are also enacted, those with incomes exceeding $1 million would save, on average, over $200,000 in taxes compared to $1,000 for all other filers.

As shown below, among those who would benefit from the Trump plan, savings are the greatest for high-income filers. On average, filers with income over $1 million stand to see their taxes

[5] The results shown reflect federal income tax liability, not New York State or New York City tax liability. Almost all of the proposed Trump tax provisions do not have a direct impact on State and City tax liability. The State and City impose their own income tax rates and have their own tax brackets, standard deductions and exemptions, and do not apply different tax rates to ordinary income and capital gains income. The $200,000 limitation on itemized deductions could impact local tax liability. We assumed for the purpose of this analysis that New York State would decouple from the federal limitation.

decrease by over $113,000. Almost two-thirds of the overall projected $5 billion in savings to New York City filers would benefit households with incomes above $500,000 — despite representing fewer than 2 percent of City taxpayers.

Tax Savings by Adjusted Gross Income (AGI)

Adjusted Gross Income	Number of Filers	Median Tax Savings	Average Tax Savings	Median Change in After-Tax Income	Average Savings with Corporate Tax Reform
$0 to $25,000	1,563,356	$114	$189	0.9%	$189
$25,001 to $50,000	881,443	$566	$425	2.0%	$425
$50,001 to $100,000	794,600	$1,233	$659	2.1%	$763
$100,001 to $250,000	435,980	$1,251	$975	1.0%	$1,647
$250,001 to $500,000	85,359	$3,723	$2,827	1.3%	$6,760
$500,001 to $1 million	32,657	$20,046	$20,555	4.3%	$34,856
More than $1 million	25,593	$76,499	$113,560	6.9%	$206,089
Overall	**3,818,988**	**$344**	**$1,371**	**1.6%**	**$2,261**

Under the Trump Plan, many moderate- and middle-income New York filers stand to lose, and will face higher tax bills

Almost one in three middle-income New Yorkers with income between $50,000 and $250,000 would be worse off.

Head of Household filers — typically single parents with children — are at greatest risk under the Trump plan. Almost 40 percent of all filers in this category stand to lose under the proposed plan.

Head of Household filers face a double whammy from both higher marginal tax rates and the elimination of personal exemptions. While the lowest income filers would benefit from an enhanced EITC and childcare credits, the enhanced EITC's proposed income eligibility limit of $31,200 provides no relief to Head of Household filers with income above $31,200. Higher marginal tax rates for those with AGI below $500,000, coupled with the loss of personal exemptions, puts most Head of Household filers with AGI between $50,000 and $500,000 (78 percent) worse off under the Trump plan. The more dependents these filers have, the more they stand to lose.

Nearly half of single filers with incomes between $100,000 and $500,000 also stand to lose under the proposed plan. These filers face higher marginal tax rates, the loss of the one personal exemption they are provided under current law, and do not benefit from the childcare credits nor the increased standard deduction. Overall, 12.6 percent of all single filers would face an increased tax bill under the proposed plan.

The majority of married filers across all income brackets face marginally lower tax bills under the Trump plan. Married filers with two or more dependents with income between $50,000 and $250,000 would receive relatively lower benefits because of the caps imposed on the proposed expanded childcare credits (see detailed distributional tables). These families also do not benefit from the reduction in the top marginal tax rate that high income households would get under the proposed plan.

Percent of NYC Filers with Higher Tax Liability Under Trump Plan, by Filing Status

Adjusted Gross Income	Single	Head of Household	Married	All Filers
$0 to $25,000	1.6%	12.0%	0.0%	3.6%
$25,001 to $50,000	12.1	47.4	8.3	21.4
$50,001 to $100,000	24.1	74.6	18.5	33.3
$100,001 to $250,000	45.2	93.2	26.9	39.5
$250,001 to $500,000	49.6	88.6	15.7	28.7
$500,001 to $1 million	7.4	14.9	2.4	4.2
More than $1 million	10.3	9.1	7.3	8.2
Overall	12.6%	39.7%	13.1%	18.6%

Most low-income New York City filers would receive modest gains

Many of the lowest-income filers — those with AGI less than $25,000 — stand to benefit or have their situation unchanged by the Trump plan. While many low-income filers would be better off or no worse off under the Trump plan, their after-tax income is expected to rise by less than 1.0 percent on average.

As a result of the higher standard deduction, married couples with income (below $30,000) and singles with income less than $15,000, would face no tax liability under the Trump plan. Under current law, a single filer with income of $15,000 would be able to deduct only $10,350 (the $6,300 standard deduction and one personal exemption of $4,050) leaving $4,650 to be taxed.

In addition, under the Trump plan some married and Head of Household filers also stand to benefit somewhat from the enhanced EITC credit for childcare expenses.

It is important to note that many of the details surrounding the implementation of the childcare tax credits have yet to be clearly delineated. Many low-income filers cannot avail themselves of professional tax preparers to help with the filing of complicated forms for childcare and dependent care expenses (IRS form 2441). To the extent that these forms become even more cumbersome, the potential benefits offered by the plan could be greatly reduced. Even though the proposed childcare expense exclusion would also apply to costs for stay-at-home parents and grandparents, this would provide little benefit to families who cannot avail themselves of grandparents or a parent to take care of young dependents and assign these responsibilities to older siblings or other relatives that are not covered under the Trump plan. According to study by the U.S. Census Bureau "Who's Minding the Kids, Childcare Arrangements" almost 20 percent of low income children are assigned to the care of siblings/other relatives.

Potential Cuts to Social Services and Other Federal Programs in NYC Could be Used to Pay for the Plan

With a median tax cut of just $293 for those making less than $50,000, the modest cut in liability could be offset in quality of life declines citywide as a result of Federal cuts. As such, even those who would pay slightly lower taxes under the Trump plan could see disproportionate harm to New York City services in order to pay for those potential tax cuts nationwide.

The President's recently released "skinny budget" for Federal Fiscal Year 2018 proposes outright elimination of several Federal aid programs that would result in at least $400 million in cuts to City programs, and unspecified potential cuts to billions of dollars in other Federal aid. Programs proposed for elimination include:

- **Community Development Block Grant**s (CDBG): The City has budgeted $225 million in CDBG funds in City FY 2018. Over half our CDBG funds are used to fund housing code enforcement activities, including housing inspections, emergency heat and hot water repairs, and lead-based paint mitigation and removal. CDBG funds also support a multitude of other programs, such as senior centers and meals, family homeless shelter operations, vacant lot cleaning, city planning, and adult literacy programs, among others.
- The **Low-Income Home Energy Assistance Program**, which helped some 770,000 New Yorkers keep their homes warm in winter ($23 million).
- $108 million in **Title II grants to DOE** that help increase the number of highly-effective teachers and principals in schools.
- **Community Services Block Grants** ($48 million), which fund rental assistance, summer youth employment (SYEP), and adult literacy programs.

In addition, the President's budget would cut **Homeland Security Grants** that support NYPD counterterrorism, as well funding to **public housing** and **Section 8** rental vouchers by at least 13 percent, and would cut critically-needed public housing capital funding by fully two-thirds.

The President's budget is silent on several critical aid programs, for example:

- **TANF:** $1.8 billion in City FY 2018;
- The **Child Care and Development Block Grant**, $523 million
- The **Social Services Block Grant**, $206 million
- **Head Start**, $131 million
- The **School lunch program**, $302 million

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