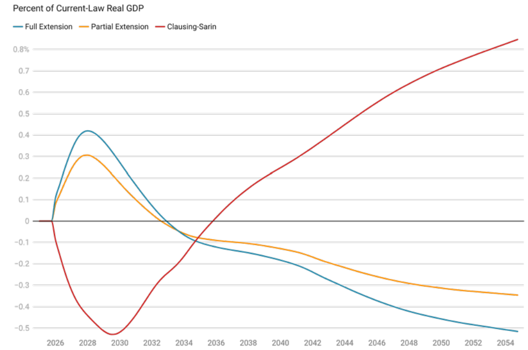
TAX CUTS AND JOBS ACT (TCJA)

Most individual income tax provisions of the Tax Cuts and Jobs Act (TCJA) expire at the end of 2025. The Budget Lab (TBL) analysed three options for tax reform surrounding expiration:

1. A scenario in which all elements are extended (**“Full Extension”**)
2. An option which preserves cuts for all but the highest-earning Americans (**“Partial Extension”** – which is The Budget Lab’s attempt at a version of extension that aligns with President Biden’s campaign promises)
3. And a tax plan that includes deficit reduction proposed by professors Kimberly Clausing and Natasha Sarin (**“Clausing-Sarin”**).

These three options highlight the trade-offs that policymakers will face in 2025.

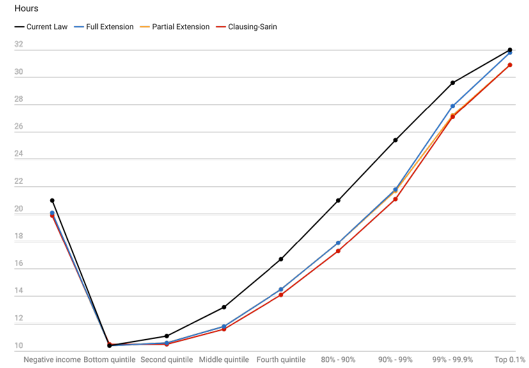
Change in Real GDP Level From Current Law, 2025-2054



EXAMINING EFFECTS ON GDP LEVELS

In the short run, extending the TCJA leads to higher real GDP levels, while a deficit-reducing tax plan that incentivizes investments leads to lower real GDP levels. In the long run, however, the deficit-reducing plan leads to higher real GDP, while TCJA extension leads to a slightly lower level of real GDP than we would have seen if the tax cuts had been allowed to expire.

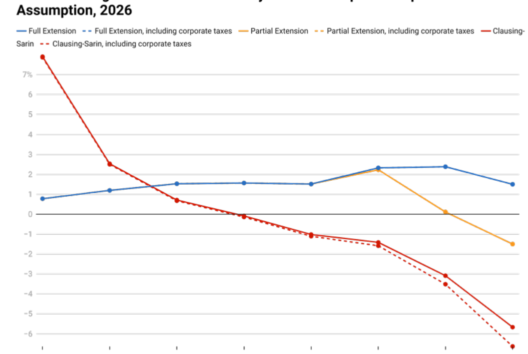
Average Time Burden of Tax Compliance by Income Group



EXAMINING EFFECTS ON TAX COMPLIANCE

The report also estimates how each reform would affect tax compliance time. Some elements of the TCJA (such as the QBI deduction) increased the time burden associated with filing taxes, whereas others (like the reduction in itemizing and alternative minimum tax filers) reduced it. On net, the Full and Partial Extension options would decrease the burden of filing taxes by an estimated 1.3 hours on average. The Clausing-Sarin scenario further lowers average tax compliance burdens by allowing the QBI deduction to expire entirely. Finally, TBL estimates that the number of returns for which information could plausibly be pre-populated by the IRS would rise from roughly 36 percent to almost 39 percent in both scenarios.

Percent Change in After-Tax Income by Income Group and Corporate Tax Assumption, 2026



Estimate universe is nondependent tax units, including nonfilers. "Income" is measured as AGI plus: above-the-line deductions, nontaxable interest, nontaxable pension income (including OASI benefits), and employer-side payroll taxes. Income percentile thresholds are calculated with respect to positive income only and are adult-weighted.

EXAMINING EFFECTS ON INEQUALITY

The Full Extension option cuts taxes, on average, for each income group. In relative terms, the tax cut is largest for those in the top 10 percent of the income distribution, increasing after-tax incomes by more than 2 percent. The bottom quintile, a group that includes many tax units that do not have income, sees after-tax incomes rising by less than 1 percent on average. Under Clausing-Sarin, families in the bottom two quintiles are net beneficiaries due to larger refundable tax credits, which more than offset the lack of tax rate reductions. The middle quintile also remains a net beneficiary under Clausing-Sarin, though less so than under Full Extension. Tax units in the top quintile owe more under the proposal, and those within this group owe more as income rises.

CHILD TAX CREDIT (CTC)

The expiration of the TCJA gives policymakers an opportunity to think about their priorities in the tax code. As we have shown, extensions of the TCJA will lead to higher real GDP in the short run, at the expense of long-term economic growth, inequality, inflation, interest rates, and the deficit. An alternative plan would lower real GDP in the short run but improve the other metrics and lead to better outcomes for children. One major change expiring in 2026 is the Child Tax Credit (CTC) provisions.

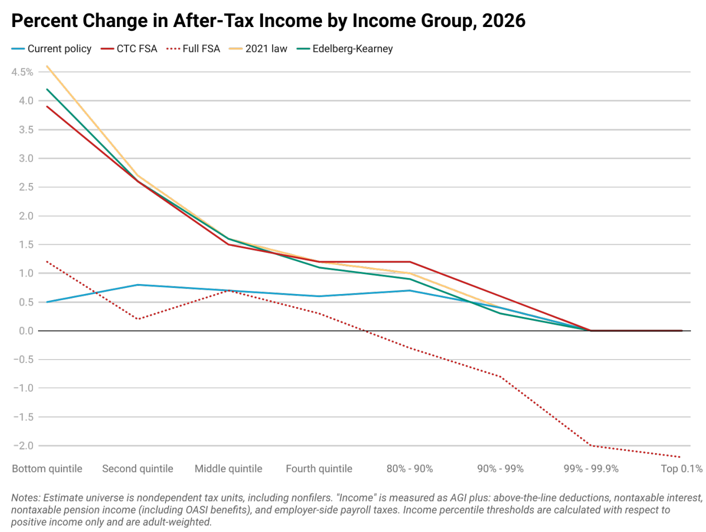
The report explores four reform options for the CTC:

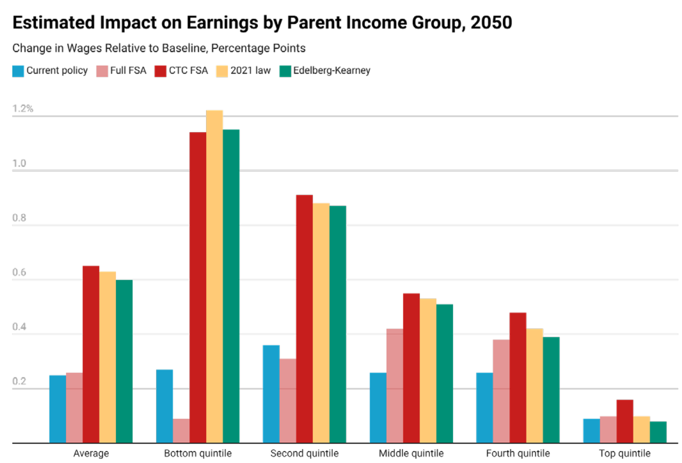
1. *Current Policy* is a straightforward extension of the current CTC design, which was first enacted under the TCJA.
2. *The Family Security Act 2.0* ("FSA") is a proposal by Senators Romney, Burr, and Daines. It would consolidate several child provisions in the tax code and expand the CTC, especially for parents of young children, in a way that strengthens the credit's incentive for parents to participate in the labor force.
3. *2021 Law* would revert CTC parameters to those of 2021, when ARPA temporarily increased the maximum credit value and removed all earnings requirements.
4. *Edelberg-Kearney*, based on a Brookings Institution white paper, is designed to maintain current policy work incentives while providing some amount of relief for those with no earnings.

All reform options would have small effects on macro-economic aggregates such as real GDP, inflation, and interest rates, although including a pay-for improves the long-run growth and budgetary outlook.

HOW DO DIFFERENT CTC OPTIONS IMPACT INCOME ACROSS THE DISTRIBUTION? We find that under the FSA CTC, Current Policy, and Edelberg-Kearney, 100,000-150,000 fewer people would decide to work, while under the 2021 Law, 200,000 fewer people would decide to work. The Full FSA, which contains pay-fors, would have different impacts at different income levels. The elimination of the SALT deduction would raise taxes on the top 20 percent of families by income, outweighing any benefits from the larger CTC for this group. The EITC cuts and elimination of head-of-household status offset about three-quarters of the CTC benefit for the bottom quintile, and almost all of the benefit for the second quintile, which would be worse off on average than under Current Policy.

HOW DOES THE CTC IMPACT CHILDREN'S EARNINGS IN THE FUTURE? Under strong preliminary assumptions, including that cash causes 20 percent of the gap in adult earnings outcomes between high-income children and low-income children, our modeling estimates that average wages for people in 2050 who were exposed to a full 18 years of the most generous option would be more than 0.6 percent higher (about $200 in additional earnings every year, adjusted to current price levels). For bottom-quintile families, this effect is more than 1 percent (about $300).





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