The Iowa Policy Project

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December 2019

Aggravating Inequality

The two-year anniversary of the Tax Cuts and Jobs Act: Not much to celebrate for most Iowans

By Peter Fisher and Mike Owen

Overview

Two years ago this month, Congress passed and the President signed the Tax Cuts and Jobs Act (TCJA). The bill showered huge tax breaks on corporations and wealthy individuals, while doing little for most working families. In Iowa, 84 percent of the tax cuts in the bill have gone to the top 40 percent of taxpayers, while the bottom 40 percent get just 7 percent. Almost a quarter of the benefits have gone to the richest 1 percent of taxpayers, whose incomes average over $1 million. Those taxpayers are saving $35,000 a year, compared to $700 for the middle-income group, 8 percent of whom actually paid *more* in taxes. Meanwhile, the bottom fifth of Iowa taxpayers gained on average about enough for a hamburger and fries once a month.

Table 1. Tax Cuts and Jobs Act provides most benefits to the top
Impact of the tax bill in Iowa in 2020

Income Group	Income Range	Average Income	Average Tax Cut	Share of Tax Cuts	Percent with a Tax Hike	Average Increase
Poorest 20%	Less than $25,000	$13,700	-$80	1%	3%	$20
Second 20%	$25,000 to $44,400	$35,800	-$430	6%	0%	$0
Middle 20%	$44,400 to $66,400	$54,500	-$710	10%	8%	$1,080
Fourth 20%	$66,400 to $106,700	$84,200	-$1,330	18%	5%	$630
Next 15%	$106,700 to $202,800	$136,800	-$2,270	23%	6%	$960
Next 4%	$202,800 to $455,800	$277,400	-$6,690	18%	7%	$2,170
Richest 1%	$455,800 or more	$1,040,000	-$35,090	24%	1%	$27,940
ALL		$78,600	-$1,450	100%	4%	$940

Source: Institute on Taxation and Economic Policy. "TCJA by the Numbers, 2020." August 28, 2019. Data available for download. https://itep.org/wp-content/uploads/TCJA-2020-for-download.xlsx

Income inequality has been on the rise nationally and in Iowa, approaching levels last seen in the 1920s. Since 1979, the richest 1 percent of Iowans captured 30 percent of all the income gains in the state.[1] Instead of moderating these extremes of inequality, the tax bill aggravates them, leaving the richest Iowans with a larger share of the income pie after taxes than before.

The major provisions of the law make clear the priorities of the legislators:

- A huge cut in the corporate income tax rate, from 35 percent to 21 percent, which mostly benefits shareholders and CEOs with stock options;

- A doubling of the estate tax exemption, to $22 million for a couple, allowing even more inherited income to go untaxed forever, and benefiting a tiny fraction of all estates;
- A cut in individual income tax rates, including a cut in the top rate from 39.6 to 37 percent, which affects only income above $600,000 per year;
- A substantial tax cut for those with so-called pass-through income, such as income from a partnership or a proprietorship, which is heavily skewed towards the top, with the richest 1 percent of taxpayers getting more than half of all pass-through income;
- A smorgasbord of provisions and loopholes that will be exploited by the wealthy to evade taxes.[2]

The tax bill's benefits to working families, on the other hand, are small. The law includes only a token increase of $75 in the child tax credit, or no increase at all, for about 10 million children in low-income families. A single mother of two working full time at the minimum wage gets just $75 more. Meanwhile, a couple with a $400,000 income and two children, who previously would not have qualified for the credit at all, now receives a $4,000 credit.

The new law eliminates personal exemptions while doubling the higher standard deduction. These two provisions together help childless individuals or couples the most, while single parents with more than two children and married couples with more than three children are worse off than before.[3]

All told, the tax provisions affecting families with children did not change their final tax bill by very much. The changes in the child tax credit, the standard deduction, the personal exemptions, and the child and dependent care credit together saved the average family in the lowest income one-fifth of households just $60 a month, while the average family in the highest fifth saved about $390, over six times as much.[4]

Some provisions will harm working families. The tax bill repeals the individual mandate for health insurance under the Affordable Care Act. This is likely to increase insurance costs as companies raise premiums to make up for the loss of their healthiest customers, who decide to go uninsured, and will increase the share of the population at risk of medical indigency because they are uninsured.[5]

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Impact on small businesses skewed to the largest and most profitable

Most of the businesses that we think of as true small businesses — the small town grocery store, the cafe, the plumbing business, the corner gas station — are organized as so-called "pass through entities," such as sole proprietorships or partnerships. With a pass-through entity, the business itself does not pay taxes. Rather, the profits from the business are passed to the owner or the partners, who report that business income along with their other income on their individual income tax return. Most large businesses are "C" corporations, where the corporation pays corporate income taxes, and then distributes profits to the shareholders who pay tax on the dividends. Nonetheless, many large and very profitable businesses — such as hedge funds, law firms, or real estate development partnerships — are organized as pass-through entities.

Owners of small businesses are affected by the TCJA in a couple of ways. First, they may benefit from the provision allowing any pass-through business to deduct up to 20 percent of business income; in effect, at least 80 percent of their business profits are passed through to their individual income tax return, but up to 20 percent is tax-free.

Presenting this tax change as a boon to "small business" is disingenuous at best. Pass-through income is highly concentrated at the top; the richest 1 percent of households nationally receive over half of all pass-through income. And pass-through profits are a major source of income for the rich, accounting for over a fifth of the income of the top 1 percent.[6]

In Iowa, the top 1 percent of households would get 64 percent of the benefit from the pass-through deduction in 2024, while the bottom 60 percent of households would get just 1 percent (see table below). For the bottom 60 percent — those with income below $66,400 — only 4 percent would benefit at all from the pass through deduction, and the average tax cut for those getting any cut at all would be a little less than $60.

Table 2. Benefits of "small business deduction" overwhelmingly go to the richest taxpayers
Effects of the pass-through deduction on Iowa taxpayers in 2020

Income Group	Income Range	Average Income	Average Tax Cut	Share of Tax Cuts
Poorest 20%	Less than $25,000	$13,700	$0	0%
Second 20%	$25,000 to $44,400	$35,800	$0	0%
Middle 20%	$44,400 to $66,400	$54,500	-$10	1%
Fourth 20%	$66,400 to $106,700	$84,200	-$30	3%
Next 15%	$106,700 to $202,800	$136,800	-$120	7%
Next 4%	$202,800 to $455,800	$277,400	-$1,580	25%
Richest 1%	$455,800 or more	$1,040,000	-$15,820	64%
ALL		$78,600	-$250	100%

Source: Institute on Taxation and Economic Policy

Second, small businesses may benefit from larger depreciation deductions. The new law doubled the limit on the amount of new investment in machinery or buildings that can be fully depreciated the first year (expensing) to $1 million. But the higher ceiling on what is allowed benefits only the largest businesses that have so much in deductions that they would bump against the old ceiling. Smaller businesses were already deducting all they could, with expenses below the old ceiling.

So the story remains the same: the tax bill showers most of its benefits on the highest income business owners.[7]

Most farmers see little benefit

All but about 2 percent of farms in the U.S. are organized as pass-through entities.[8] The remainder are very large corporate farms, and though they are few in number they account for about 10 percent of U.S. farm output. Corporate farms would benefit largely from the huge cut in the corporate income tax rate.

With a pass-through entity, the profits of the farming operation are "passed through" to the individual or family, and taxed as part of their overall income under the individual income tax. Thus farm families are impacted by all of the TCJA provisions affecting the individual income tax, with benefits skewed heavily towards the top income groups. Two additional features of the law, however, affect farming operations just as they do small businesses in general: depreciation deductions and a pass-through income deduction.

The change in depreciation described above for small businesses in general helps only a few of the largest farms — those with gross farm income over $1 million, representing just 3 percent of farms.[9] The higher ceiling on what is allowed is no benefit to the small farms whose equipment expenses are already well below the old ceiling.

The TCJA also creates a special provision for pass-through income, whereby up to 20 percent of such income can be deducted and therefore not subject to the individual income tax. According to the latest statistics from the IRS, of all individual income tax returns with farm income, 41 percent had AGI (adjusted gross income) of under $50,000, and 91 percent had AGI of under $200,000. The latter group would include all considered "small family farms" by the USDA, and most of the "midsize family farms," a group that had an average farm income of $119,140 and average overall AGI of $185,684. (IRS statistics are reported by the AGI class for the tax return, where AGI includes income from all sources — farm income from Schedule F, wages and salaries from off-farm income, unearned income, and income from other businesses or self-employment.)

The IRS statistics provide insight into who would reap the benefits from the special pass-through income deduction in the 2017 tax bill. On the surface, it would seem that most farmers would benefit because 98 percent of farms are pass-through entities. However, any taxpayer with a net loss from farming would gain nothing from the ability to deduct 20 percent of pass-through income from farming (because their pass-through income is negative), regardless of whether they had other sources of income that resulted in their overall AGI and taxable income being positive. Also, any taxpayer who is not taxable overall would gain nothing even if they had positive net income from farming, because losses elsewhere or non-farm deductions have already reduced their taxable income to 0. Thus the total number of farm returns that would not benefit, at least initially, from the pass-through deduction is equal to the total that are not taxable, plus the taxable returns with a net loss from farming.

IRS statistics show all tax returns with farm income filed for tax year 2017. Among those returns with less then $50,000 AGI, 91 percent would get no benefit from the pass through deduction. Among returns with less than $200,000 AGI, which includes all small and most midsize family farms, 83 percent would have gotten no benefit from the deduction, at least initially. (Because of the complexity of the law and the associated IRS regulations, it is not clear whether or not some of those farms would derive some benefit subsequently.)

Under the estate tax prior to TCJA, fewer than 1 in 100 farm estates (0.86 percent) owed any estate tax. Under the new law, that would drop to 1 in 1,000 (0.11 percent), based on 2016 estate tax filings — only the 43 richest farm estates in the country. If the TCJA had been in effect in 2016, it would have granted $396 million in tax savings to the 227 largest farm estates.[10] Meanwhile, 99 percent of farms are inherited free of any estate tax, even under previous law.

The story for farmers, in other words, is the same as the story overall: the tax bill is heavily skewed towards those with the most income and wealth. For the average family farm, the TCJA provides little benefit.

Impact on seniors

There are few provisions of the law specifically impacting seniors, other than the general provisions affecting all taxpayers. The massive revenue losses produced by the bill, however, will put increasing pressure on the Medicare and Social Security programs as Congress seeks to offset the mounting deficits.

For seniors in Iowa, the benefits of the tax bill are even more heavily skewed to higher income groups than they are for non-seniors. The richest 40 percent of seniors will get 91 percent of the tax break going to seniors, while the poorest 40 percent get just 2 percent of the total. Among the middle income group, with incomes between $44,000 and $66,400, 12 percent will actually see a tax increase. For the rest of that group, the average tax cut comes to less than $10 a week. The average tax cut for the richest 1 percent of Iowa seniors — those making on average over $1 million a year — will be $45,590.

Table 3. Benefits to Seniors Concentrated at the Top
*Effect of the tax bill on Iowa seniors in 2020**

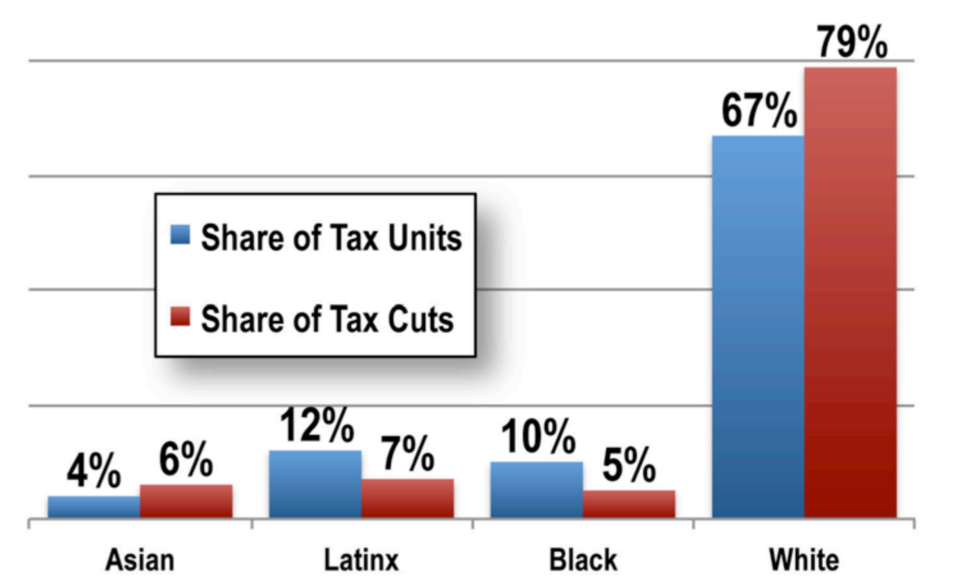
Income Group	Income Range	Seniors' Average Income	Average Tax Cut	Share of Tax Cuts	Percent with a Tax Cut	Average Cut	Percent with a Tax Hike	Average Increase
Poorest 20%	Less than $25,000	$17,500	-$60	0%	72%	-$80	0%	$0
Second 20%	$25,000 to $44,400	$34,300	-$110	2%	84%	-$130	0%	$0
Middle 20%	$44,400 to $66,400	$55,500	-$390	7%	82%	-$490	12%	$150
Fourth 20%	$66,400 to $106,700	$82,900	-$1,070	18%	96%	-$1,120	1%	$130
Next 15%	$106,700 to $202,800	$133,000	-$2,400	22%	96%	-$2,510	3%	$560
Next 4%	$202,800 to $455,800	$273,200	-$5,720	20%	89%	-$6,640	11%	$1,870
Richest 1%	$455,800 or more	$1,142,700	-$45,590	32%	99%	-$31,640	1%	$4,110
ALL		$83,400	-$1,400	100%	87%	-$1,470	4%	$410

**Includes the blind, who in many ways are taxed like seniors.*
Source: Institute on Taxation and Economic Policy.

Persons of color less likely to benefit

The TCJA provides a disproportionate share of the benefits to white taxpayers, because the high-income taxpayers who are the primary beneficiaries of the law are predominantly white. At the national level, black tax units (a tax unit is an individual or a family filing a tax return) represent 10 percent of all tax units, but get only half their share, or 5 percent of all the tax cuts. Similarly, Latinx tax units are 12 percent of all units but receive only 7 percent of the tax cuts.

Figure 1. Disproportionate benefit to white families
Effect of the tax bill by race — nationally — in 2020



Source: Institute on Taxation and Economic Policy

Impact on workers

Workers are, of course, affected directly by the tax law through the overall impact of the various tax changes, as described above. A single person or a single parent earning minimum wage and working full time would make only about $15,000 per year, placing them squarely in the bottom 20 percent of all households by income. They would gain little or nothing from the law — the average tax break for such households is about $7 a month. Even with a $17 an hour job — the median wage in Iowa — the tax bill provides only around $400 a year in savings, the average for those in the $25,000 to $44,000 income range in Iowa.[11]

There is a more insidious effect of the TCJA on workers, however. The pass-through income deduction that benefits mostly wealthy households also creates an incentive for businesses to replace employees with independent contractors or to outsource work to independent firms. Because independent contractors could deduct 20 percent of the payments for their services (because they are proprietors of a pass-through business), the company could pay less for their services than they would have to pay in wages. The independent contractors, however, have to find their own health insurance, fund their own retirement, have no vacation or sick leave, and receive none of the workplace protections afforded actual employees, such as the minimum wage. They are unlikely to be unionized. The tax bill, in others words, has incentivized the weakening of worker benefits and protections.

Opportunity zones: Redevelopment tool or just another tax break for the rich?

There have been a number of state and federal attempts over the years to revitalize declining or high poverty neighborhoods through tax incentives, but their success is open to question.[12] Undeterred, the TCJA created yet another incentive program, Opportunity Zones, aimed at channeling funds into real estate and business projects in high poverty areas.

States designate Qualified Opportunity Zones (QOZ) based on historical poverty rates; Iowa has designated 62 census tracts as QOZs across the state, in both rural areas and cities. These zones are now eligible for investment under the program; that investment must come from a Qualified Opportunity Fund (QOF) set up under the provisions of the TCJA. An individual or corporation does not invest directly in a project in an opportunity zone, but rather in a fund, which then pools contributions from many investors and funnels them to various projects in any number of zones.

The Opportunity Zone program's avowed aim is to channel "unrealized capital gains" into investments in poverty neighborhoods. What are these capital gains? Investors have purchased land or buildings, or shares of stock, or some other asset, in the hopes that they will increase in value, and can then be sold for a profit. The increase over what the investor originally paid for the asset is called a capital gain. It is an "unrealized gain" if the investor still owns the asset; when it is sold, the gain is "realized" and only then is it taxed as income.

By one estimate, investors nationwide are sitting on about $6 trillion of unrealized capital gains.[13] To entice investors to put some of those gains in a QOF, the tax law provides three kinds of incentives. First, if they sell an asset and reinvest the realized capital gain in a QOF, the gain from the sale is not taxed as it normally would be; instead the tax due is deferred until the investment in the QOF is sold. Second, if they leave their money in the QOF for at least five years, 10 percent of that original gain goes tax free; this increases to 15 percent if they leave it in seven years. Finally, any subsequent capital gain earned from the investment in the QOF itself is tax free if the investor leaves the money in the fund for at least 10 years.

If you were an investor looking to park your capital gains somewhere, surely you would pick the place that promised the greatest future increase in the value of your investment, an increase that will go tax free. So you pick the zone that needs help the least, where a new business can be most profitable, or where real estate values are most likely poised to grow. Those are likely to be the least poor areas among the eligible opportunity zones, or the areas ripe for gentrification.

So who is it that stands to benefit from this special tax break for capital gains? Not surprisingly, it is the very rich. In 2017, the richest 1 percent of federal income tax payers — those with incomes of $200,000 or more — earned 54 percent of all taxable capital gains.[14] The richest fourth of taxpayers, with incomes above $200,000, accounted for 84 percent of all gains.

What will the program do for the residents of Opportunity Zones, who are ostensibly the ones the program is trying to help? Because the funds are not likely to be aimed at the most troubled neighborhoods, but instead at those with the most potential for business growth or appreciation in real estate values, the program could well result in displacement for poor families whose substandard homes are in the way of neighborhood "renewal."

Unfortunately, Iowa failed to decouple the state income tax from the federal opportunity zone provision.[15] That means that Iowa will be giving individuals and corporations a state tax break for investing in an opportunity fund, even though that fund invests in multiple projects across many states. There are 57 national funds that will potentially invest in any state, but an Iowa taxpayer will get a credit for investing in those funds regardless of whether that fund has any investments in an Iowa opportunity zone.[16] One listing identifies only nine funds (out of 287) that have a narrower geographic focus that includes the Midwest, but all are multi-state — none focus exclusively on Iowa. By failing to decouple, Iowa is subsidizing wealthy Iowans for investments made in other states, to the detriment of the state treasury and the rest of Iowa taxpayers.

Summary

The federal income tax historically has been an important means of offsetting to a degree the extremes of income inequality generated in the U.S. economy. The Tax Cuts and Jobs Act of 2017 has been a major step backward, aggravating inequality rather than alleviating it. The law provides billions in tax cuts, heavily skewed to the richest Americans. Whether the focus is on all Iowans, or just retirees, or small business owners, or farmers, or working families, the picture remains the same: The wealthiest get most of the benefits, while the lower-income half of the population is left with little. Even the provision in the bill aimed at providing a boost to low-income neighborhoods will probably do little to help the poor while providing yet another way for those at the top to avoid taxes. On this two-year anniversary of the bill, there is not much to celebrate for the majority of Iowans.

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[1] Estelle Sommeiller, Mark Price, and Ellis Wazeter. *Income inequality in the U.S. by state, metropolitan area, and county*. Economic Policy Institute, June 16, 2016. https://www.epi.org/publication/income-inequality-in-the-us/

[2] Chuck Marr, Brendan Duke, and Chye-Ching Huang. *New Tax Law Is Fundamentally Flawed and Will Require Basic Restructuring.* Washington, D.C.: Center on Budget and Policy Priorities. October 31, 2018. https://www.cbpp.org/research/federal-tax/new-tax-law-is-fundamentally-flawed-and-will-require-basic-restructuring

[3] This is based on a comparison of personal exemptions plus the standard deduction for tax year 2017 with the higher standard deduction but no personal exemptions for tax year 2018.

[4] Elaine Maag. "The TCJA Didn't Change Child Benefits For Most Families With Children By Very Much." Tax Policy Center, October 8, 2019. https://www.taxpolicycenter.org/taxvox/tcja-didnt-change-child-benefits-most-families-children-very-much

[5] Aviva Aron-Dine, "Senate Tax Bill Would Add 13 Million to Uninsured to Pay for Tax Cuts of Nearly $100,000 Per

Year for the Top 0.1 Percent," CBPP, November 15, 2017. https://www.cbpp.org/blog/senate-tax-bill-would-add-13-million-to-uninsured-to-pay-for-tax-cuts-of-nearly-100000-per-year.

[6] "Pass-Through Deduction Benefits Wealthiest, Loses Needed Revenue, and Encourages Tax Avoidance." Center on Budget and Policy Priorities, March 27, 2019. https://www.cbpp.org/research/federal-tax/pass-through-deduction-benefits-wealthiest-loses-needed-revenue-and-encourages

[7] The TCJA also created a new tax credit for employer-paid family and medical leave that can be taken in 2018 and 2019. The credit is applied to employees earning less than about $72,000 per year. It is not clear how many small businesses will take advantage of such a credit; benefits are generally less generous in smaller firms, and paid family or medical leave is not usually considered a basic benefit.

[8] James M. Williamson and Siraj G. Bawa. *Estimated Effects of the Tax Cuts and Jobs Act on Farms and Farm Households.* Economic Research Report Number 252. United States Department of Agriculture, Economic Research Service. June 2018, p. 3. https://www.ers.usda.gov/webdocs/publications/89356/err-252.pdf?v=43278

[9] Williamson and Bawa, pp. 11-12.

[10] Williamson and Bawa, pp. iii.

[11] Beyond the overall impact of the tax changes, some working people may be disadvantaged by the end of the deduction for unreimbursed job expenses. Under prior law, "miscellaneous itemized deductions" could be deducted to the extent that the total of such deductions exceeded 2% of AGI. All of these deductions were eliminated, including work-related expenses an employee pays out of his or her own pocket. This includes such things as tools and supplies used in your work, work clothes and uniforms, union dues, work-related travel expenses, work-related education and expenses of looking for a new job. These deductions were taken only by those who itemized deductions, and then only the amount above 2 percent of AGI was deductible. It is likely that most lower and middle income workers do not itemize deductions at all under the new tax law because the standard deduction has been doubled. Thus few are likely to be disadvantaged by the loss of the deduction, which would affect only those with large employee expenses but low enough income that the 2 percent of AGI threshold would not eliminate those deductions, and who also had high deductions for mortgage interest, property taxes, or other costs so that it still paid to itemize.

[12] Michael Mazerov. "Too Soon for States to Consider 'Opportunity Zone' Tax Breaks. Center on Budget and Policy Priorities. May 1, 2019. https://www.cbpp.org/blog/too-soon-for-states-to-consider-opportunity-zone-tax-breaks

[13] Danny Vinik. "The Gap in the GOP's Economic Plan". Politico, Nov. 20, 2019. https://www.politico.com/agenda/story/2018/11/20/opportunity-zones-republican-tax-law-000789

[14] The Tax Policy Center of the Urban Institute and the Brookings Institution. https://www.taxpolicycenter.org/statistics/capital-gain-income

[15] Iowa couples automatically with the Federal definition of income; since the TCJA allows Federal taxpayers to exclude the capital gains invested in a QOF from income, temporarily or permanently, those gains will not become part of Iowa taxable income either. Iowa could enact a law decoupling from this particular part of the federal internal revenue code.

[16] Of the 287 Qualified Opportunity Funds identified by the Opportunity Zones Resource Center, 57 have a nationwide focus. https://www.novoco.com/resource-centers/opportunity-zone-resource-center/opportunity-funds-listing

Authors and acknowledgements

Peter Fisher is research director and Mike Owen is executive director of the nonpartisan Iowa Policy Project in Iowa City. The Iowa Policy Project is a nonprofit public policy research organization that reports on Iowa public policy and federal policy effects on Iowans in the areas of budget and tax issues, economic opportunity, and energy and the environment.

This report was created with support from Tax March Iowa and funded by Tax March. The findings and conclusions of this report are solely those of the Iowa Policy Project authors.