

The US Individual Income Tax: Recent Evolution and Evidence

Jon Bakija
Williams College

Latest estimates of revenue and distributional effects of making TCJA *individual* provisions permanent

- Fiscal year 2027 revenue loss: **1.2 percent of GDP** (CBO and JCT)
- Distributional effects in 2027 (Tax Policy Center)

Part of income distribution	Federal tax change as a percentage of income	Average federal tax change in dollars
Top one percent	-2.0	-63,790
Next highest four percent	-2.2	-14,860
Middle quintile	-1.0	-950
Bottom quintile	-0.5	-110

Sources:

<https://www.cbo.gov/system/files/2024-05/60114-Data.xlsx>

<https://www.cbo.gov/system/files/2024-06/51135-2024-06-Economic-Projections.xlsx>

<https://www.taxpolicycenter.org/model-estimates/make-certain-provisions-2017-tax-act-permanent-july-2024/t24-0037-make-certain>

TCJA dramatically reduced itemization and exposure to the alternative minimum tax (AMT)

- Standard deduction nearly doubled, and deduction for state and local taxes was capped at \$10,000
- Percentage of tax returns itemizing deductions:
 - 31% in 2017
 - 9% in 2021
- Benzarti (2020) estimates compliance cost of itemizing is between 0.6% and 0.9% of adjusted gross income
- Increase in AMT exemption reduced number of taxpayers subject to AMT from 5 million in 2017 to 244,000 in 2018
 - IRS estimate from 2000: taxpayers devoted 12 hours to AMT for every person who paid the AMT

Is reducing itemization a good thing? Part 1: charitable contributions

- Itemized deduction reduces price of \$1 of donation to \$1 minus the tax savings from the donation (usually marginal tax rate)
- Well-identified prior studies suggested a price elasticity of donations of around -1, which would imply that TCJA would reduce individual donations by 7%
- Han, Hungerman, and Ottoni-Wilhelm (2024) compare how donations changed from 2016 to 2018 for people predicted to switch from itemizing to standard deduction, relative to others
 - They also estimate TCJA caused a 7% decline in individual donations
- Positive externalities provide a strong rationale for subsidizing charitable donations
 - But this could also be done with a flat-rate refundable tax credit

Is reducing itemization a good thing? Part 2: housing

- Deduction for mortgage interest is problematic when so much capital income (including return on homes) goes untaxed
- Gruber, Jensen, and Kleven (2021) find that tax savings from mortgage interest deduction does not increase homeownership, but causes people to buy more expensive homes and take on more debt (inefficient)
- Evidence of positive externalities from homeownership is weak (Engelhardt *et al* 2010)
- Sodini *et al* (2023) find homeownership has benefits in terms of promoting saving and consumption smoothing
- Taken together, this suggests something like a first-time homebuyer credit would be better than a home mortgage deduction

Is reducing itemization a good thing? Part 3: state and local taxes

- Efficiency and equity questions about the SALT deduction
- Altig et al (2020) find that in top 10% of income distribution TCJA cut taxes by 2% in red states and 1.2% in blue states
- Curtailing the SALT deduction exacerbates spatial misallocation (people don't live where they'd be most productive)
 - Albouy (2009); Fajgelbaum et al (2019); Moretti and Wilson (2017); Coen-Pirani and Sieg (2019)
- Young and Lurie (2022) find the cross-state migration response of millionaires to TCJA is very small

The child tax credit

- Doubled by TCJA (in exchange for eliminating personal exemption)
- Temporarily increased even more, and made fully-refundable, in 2021
 - Reduced incentive to work, but Ananat et al (2023), Enriquez, Jones, and Tedeshi (2023) and Pac and Berger (2024) find no impact on labor supply
- Kleven (2024) reassesses evidence on labor supply response to EITC, and argues response is small
- Kelven (2014) and Luksic (2020) cross-country evidence: subsidizing complements to work (e.g., child care) more than offsets negative effects of transfers to low-income people on labor supply
- Evidence summarized in Aizer, Hoynes, and Lleras-Muney (2022) and Garfinkel (2022) documents large long-run benefits from transfers to poor children
- Strengthens the case for larger refundable child credits

Cuts to marginal individual income tax rates

- TCJA cut effective federal marginal tax rates on labor income by 2%, on average
 - Cut in combined federal-state marginal income tax rates was significantly smaller because of cap on SALT deduction and reduced itemization
- Piketty, Saez, and Stantcheva (2014) find that countries that cut top marginal income tax rates more since the 1960s saw larger increases in top 1%'s share of pre-tax income reported on individual tax returns, but not faster GDP growth
 - Could be explained by some combination of changes in rent-seeking, and changes in tax avoidance and evasion
 - They argue the social-welfare maximizing top income tax rate is between 62 percent and 83 percent