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INSIGHT

Changes in After-Tax Income from the Tax Provisions in the "Build Back Better Act"—Distributional Analysis

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Distributional analysis can be used to illustrate how changes in tax policy may affect the economic well-being of taxpayers. Broadly, distributional analyses can be used to examine how system-wide tax burdens are shared across taxpayers, or the "fairness" of the tax system. The Joint Committee on Taxation (JCT) regularly prepares distributional analyses of major tax proposals. On September 14, 2021, JCT released a distributional analysis of the revenue provisions of the House Ways and Means Committee's budget reconciliation legislative recommendations (described in this CRS report). These proposed changes are in Title XIII, Subtitle H, of what is being referred to as the "Build Back Better Act."

One useful metric for understanding the impact of tax policy on taxpayers' well-being is the percentage change in after-tax income. **Figure 1** illustrates the percentage change in after-tax income that would result from the revenue (or tax) provisions recommended by the Ways and Means Committee. These calculations are made relative to current law, which assumes that the temporary provisions enacted as part of P.L. 115-97 (commonly referred to as the "Tax Cuts and Jobs Act" (TCJA)) expire at the end of 2025, as scheduled. For 11 different income categories, **Figure 1** illustrates how the proposed tax policy modifications would change the after-tax income of taxpayers relative to current law in 2023, 2025, 2027, 2029, and 2031.

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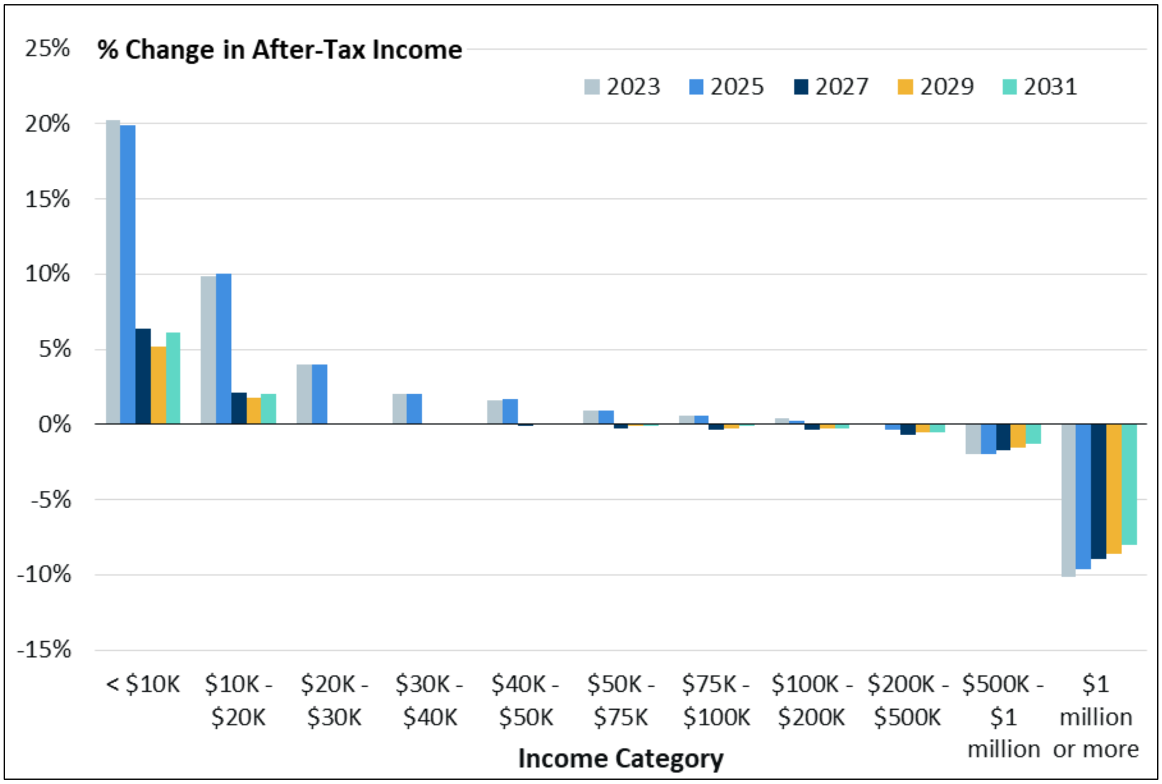
Figure 1. The Revenue Provisions in the Build Back Better Act: Estimated Changes in After-Tax Income



Source: Joint Committee on Taxation, JCX-44-21.

Notes: JCT provided estimates for odd years only. The percentage change in after-tax income is calculated using JCT's average tax rate estimates as [(1 – proposal average tax rate) – (1 – present law average tax rate)] / (1 – present law average tax rate). Income is measured as adjusted gross income (AGI) plus other items, as described by JCT.

Taxpayers with the largest benefit under the Build Back Better Act recommendations according to JCT's estimates are the lowest-income taxpayers, with the largest benefits occurring before 2026. Taxpayers with income of less than $10,000 or in the $10,000 to $20,000 range would have the largest percentage increase in after-tax income. In 2023 and 2025, the proposed tax policy changes would increase after-tax incomes by 20% (on average) for taxpayers with income of less than $10,000. In these same years, the proposed tax policy changes would increase after-tax income by 10% (on average) for taxpayers with income in the $10,000 to $20,000 range.

The changes in after-tax income for the lowest-income groups can largely be explained by proposed changes to the child tax credit. The American Rescue Plan Act of 2021 (ARPA; P.L. 117-2) expanded the child tax credit for 2021. The three changes in ARPA (1) allowed taxpayers to claim the credit for 17-year-old children; (2) made the credit "fully refundable," a change that particularly benefits lower-income taxpayers; and (3) increased the maximum credit amount (from $2,000 to $3,600 for children younger than 6 and to $3,000 for children 6 to 17 years old). The proposed child tax credit changes in the Build Back Better Act would effectively extend the expanded child credit in effect in 2021 through the end of 2025. After 2025, the credit would return to its pre-ARPA and pre-TCJA levels, but permanently be fully refundable.

After 2025, the tax policy changes proposed in the Build Back Better Act would continue to increase the after-tax income of taxpayers in the under $10,000 and $10,000 to $20,000 income groups. The increase, however, would not be as large (between 5% and 6% for the under $10,000 group, and about 2% for the

$10,000 to $20,000 income group). Policy changes other than changes to the child tax credit, namely the changes to the earned income tax credit (EITC) and child and dependent care tax credit (CDCTC), likely explain much of the estimated increase in after-tax income. Similar to the child tax credit, ARPA temporarily increased (for 2021) the EITC and CDCTC. The Build Back Better Act proposes to make permanent the EITC and CDCTC changes made in ARPA (as opposed to the child tax credit changes, which would be extended through 2025).

The proposed tax policy changes in the Build Back Better Act would decrease after-tax income for those toward the top of the income distribution. After-tax income would be reduced by 2% (on average) for taxpayers in the $500,000 to $1 million income category in 2023, and 10% (on average) for taxpayers in the $1 million or more income category. A number of revenue-raising provisions explain the decrease in after-tax income for those at the top of the income distribution. One is the increase in the top corporate tax rate from 21% to 26.5%. The JCT assumes in its distributional analysis that most of the burden of the corporate tax is borne by owners of domestic capital, and owners of capital tend to be higher-income taxpayers.

Other provisions that would tend to increase tax burdens (and decrease after-tax income) for high-income individuals include (1) applying the net investment income tax to trade or business income of high-income individuals; (2) an increase in the top individual income tax rate (from 37% to 39.6%); and (3) making permanent the current temporary limit of $500,000 for joint returns ($250,000 for other returns) on business income that can offset other income. (These provisions are the three largest in terms of revenue gained among the "tax increases for high-income households" provisions.) Increasing the top individual income tax rate from 37% to 39.6% would generate more revenue before 2025 than afterward, since the current top individual income tax rate was temporarily reduced through 2025 in the TCJA. In contrast, making permanent the current limits on business losses for noncorporate taxpayers would generate more revenue after 2026, since the current limits apply through 2026.

The percentage change in after-tax income is one metric for analyzing the distributional effects of proposed changes in tax policy. JCT has also examined the share of taxpayers who would have a tax increase or tax decrease. Under the Build Back Better Act's tax provisions, JCT found that nearly all taxpayers at the top of the income distribution would have a tax increase, while the tax cuts at the lower part of the income distribution are less universal. The Tax Policy Center also has a distributional analysis, which finds that the tobacco excise tax and corporate tax increases, taken together, offset some of the progressivity of the Build Back Better Act's tax provisions generally.

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