Federal Personal Income Tax Restructuring and State Responses to Date

NCSL Budget and Revenue Committee

Michael Mazerov, Senior Fellow

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State/Federal Personal Income Tax Conformity Points and Timing

• No linkage to IRC: 5 states: AL, AR, MS, NJ, PA

• Federal Adjusted Gross Income (FAGI); most states

• Federal Taxable Income (FTI); 5 states: CO, ID, MN, ND, SC
  ➢ FAGI, minus personal exemptions (PEs) minus standard deduction (SD) or itemized deductions (IDs)

• But: 3 additional states (DC, NM, VT) link at AGI but also allow federal PE and SD amounts to be deducted; UT calculates credits based on these amounts

• “Fixed date” vs. “rolling conformity”
Potential State Base Broadening Effects of Federal Tax Bill (TCJA)

• (Very minor) changes broadening calculation of FAGI
  ➢ Repeal of moving expense deduction
  ➢ Repeal of alimony deduction
  ➢ Repeal of bicycle commuting expense
Potential State Base Broadening Effects of Federal Tax Bill (TCJA)

• Significant changes broadening calculation of FTI:
  ➢ Repeal (?) of all personal exemptions!
  ➢ SALT deductions capped at $10,000 (mostly affects state property tax deductions)
  ➢ Mortgage interest deduction capped at $750k of debt (down from $1M)
  ➢ Switch to slower-growing “chained CPI” for indexing
Potential State Base Broadening Effects of Federal Tax Bill (TCJA)

• Sleeper issue:
  ➢ Did TCJA repeal personal exemptions or set them to $0?
  ➢ Many states that don’t conform to amounts of PEs do rely on counts of federal PEs to determine number of state-specific PEs (or personal credits) that can be claimed
  ➢ Laws in many states are ambiguous as to whether TCJA eliminated their PEs/credits
  ➢ States coming down differently on this question
Potential State Base Narrowing Effects of TCJA

• Affecting calculation of FAGI:
  ➢ Sleeper issue: expansion of Section 529 education savings plans to allow use for K-12 expenses

• Affecting calculation of FTI:
  ➢ Near doubling of SDs!
  ➢ Deduction of 20% of Qualified [passthrough] Business Income (QBI)
  ➢ Elimination of “Pease” phase-out of IDs for high-income taxpayers
  ➢ Lower threshold for claiming medical expenses
Other Potential State Base Effects of TCJA

• 6 states (AL, IA, LA, MO, MT, OR) allowed full or partial deduction of federal PIT in calculating state PIT

  ➢ Significant potential revenue gain in AL, IA, LA because TCJA cuts PIT liability substantially and federal deduction unlimited

  ➢ Less significant potential revenue gain in MO, MT, OR because deduction was capped

• Potential significant revenue gain in ME because conforms to repealed PE but not expanded SDs

• Potential significant revenue loss in MO and NE because conform to increased SDs but not repealed PEs
Federal/State Itemized Deduction Links Could Increase State PIT for Many Taxpayers

• ~17 states require taxpayers that claim SD on federal return to do same on state return

• Many more taxpayers will now claim SD because of its near doubling combined with restrictions on IDs (e.g. SALT cap)

• Not a problem for taxpayers in states that link to TI or AGI+federal SD; SD will go up at state level by same amount

• But for states whose SDs aren’t increased (because not linked at all or because fixed date state didn’t roll conformity date to 1/1/18), these taxpayers will see state PIT liability increase

• E.g., KS jt. filer with $20,000 IDs will find it advantageous to claim $24,000 federal SD, but will now have to claim $7,500 KS SD, so state PIT liability increase will offset federal cut
In TI and (AGI+SD+PE) States, Many Families with Children Could Experience Tax Increases

• Leaving aside other aspects of TCJA conformity that could decrease state PIT liability (e.g., QBI), all married couples with children and heads of households with more than one child will experience tax increases as net effect of elimination of PEs and increase in SDs

• The more children, the greater the tax increase

• Doesn’t happen under federal PIT because TCJA also increased child tax credit (CTC)

• Only CO, NY, OK linked in any way to federal CTC; CO’s not large enough to counteract tax increase from PE/SD combination

• Also tax increases for taxpayers who continue to itemize
In TI and (AGI+SD+PE) States, Many Families with Children Could Experience Tax Increases

### Increased Standard Deduction Does Not Offset Loss of Personal Exemptions for Most Families with Children

<table>
<thead>
<tr>
<th></th>
<th>Current Standard Deduction</th>
<th>TCJA Standard Deduction</th>
<th>Increase in Standard Deduction</th>
<th>Loss of Personal Exemptions ($4150 per person)</th>
<th>Change in Taxable Income</th>
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<tbody>
<tr>
<td><strong>Married Filing Joint</strong></td>
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<td>$16,600</td>
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<td><strong>Head of Household</strong></td>
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</table>
Potential Net Effects on States of TCJA Conformity – and How They Responded

• 9 states with no personal income taxes (AK, FL, NV, NH, SD, TN, TX, WA, WY) unaffected by TCJA PIT changes

• 5 states with no federal conformity points (AL, AR, MS, NJ, PA)

• 15 AGI conformity states minimally affected (e.g., because allow no IDs) and took no action or merely moved conformity date forward

  ➢ AZ, CA, CT, DE, HI, IL, MA, NY, NC, OH, OK, RI, VA, WI, WV

  ➢ But some of these states have open question as to whether their PEs/personal credits were repealed
Potential Net Effects on States of TCJA Conformity – and How They Responded

• 4 states took relatively minor actions
  ➢ AL decoupled from Section 529 expansion
  ➢ IN and NY proactively fixed PE “count” issue
  ➢ OR decoupled from passthrough QBI income deduction and instead modestly expanded pre-existing passthrough tax break
Potential Net Effects on States of TCJA Conformity – and How They Responded

- 8 states ultimately did not act on conformity, and significant revenue gains therefore occurred
  - AL: revenue gain from full deductibility of federal PIT
  - CO: Rolling TI. Therefore, QBI tax cut for many passthrough owners and tax increases for many families with children (partially offset by CTC expansion)
  - DC: Rolling AGI+federal PE+federal SD. Tax increases for many families with children and itemizers losing PEs
  - KS: Rolling AGI. Tax increases for taxpayers who switch to federal SD and therefore required to switch to much smaller KS SD
Potential Net Effects on States of TCJA Conformity – and How They Responded

- 8 states ultimately did not act on conformity, and significant revenue gains therefore **occurred**
  - LA: rolling AGI. Revenue gain from full deductibility of federal PIT
  - NM: Rolling AGI + federal PE + federal SD. Tax increases for many families with children and itemizers
  - MT: Rolling AGI. Some revenue gain from (capped) deductibility of federal PIT
  - ND: Rolling AGI. Tax increases for many taxpayers with children and itemizers, and QBI tax cuts for passthrough owners
Potential Net Effects on States of TCJA Conformity – and How They Responded

• 3 states ultimately did not act on conformity, and significant revenue gains and losses were therefore avoided

  ➢ ME: Fixed date AGI+federal PE. Preserved existing PE, avoiding significant revenue gain

  ➢ MN: Fixed date TI. Rolling forward would have led to tax increases for many families with children and itemizers and QBI tax cuts for passthrough owners. Vetoed conformity bill would have offset many effects. Tax dept. will allow federal SD claimers to continue itemizing on MN return

  ➢ SC: Fixed date TI. Rolling forward would have increased taxes for many families with children and itemizers. But bill passed by one house would have decoupled from QBI and established new $1525 PE.
Potential Net Effects on States of TCJA Conformity – and How They Responded

• In 9 states, conformity response was part of larger PIT restructuring packages that often included corporate tax changes and often changes in other taxes.

  ➢ GA, ID, IA, KY, MD, MI, MO, NE, UT

  ➢ Limited in scope in MI (fixed PE count issue and phase-in increase from $4000 to $4900) and MD (fixed PE “count” issue, increased SD modestly and indexed, increased EITC)

  ➢ ID and UT allowed PE/SD combination to increase taxes on families with children, then partially offset with new CTC in ID and rate cut in UT

  ➢ More complex packages in other states
State Responses to Passthrough QBI Tax Break

➢ CO: rolling TI; did not decouple and therefore granted

➢ ID: fixed date TI; did not decouple and therefore granted

➢ MN: did not roll TI conformity date forward and therefore not granting

➢ ND: no legislative session, and so granted due to rolling TI

➢ OR: proactively decoupled; substituted expansion of pre-existing tax break for passthroughs

➢ SC: did not roll forward fixed date TI conformity; did not grant. House-passed bill would have decoupled

➢ KY: Despite AGI link, quirk in law would have granted; proactively decoupled

➢ IA only state not coupled that proactively decided to grant (phased in based on trigger)
Most Likely Prospects for 2019 Action

• States in which there was considerable debate but ultimately no action: KS, ME, MN, SC

• State with major impact and no 2018 legislative session: ND

• States with major impacts but no significant 2018 debate: CO and NM

• More consideration of Section 529 conformity implications
Questions?

Thank you!
Michael Mazerov
mazerov@cbpp.org
www.cbpp.org/topics/
state-budget-and-tax
202.408.1080