

Federal Tax Reform and the States

Tax debate won't end, it'll move to the states

Dec. 7, 2017

Richard C. Auxier

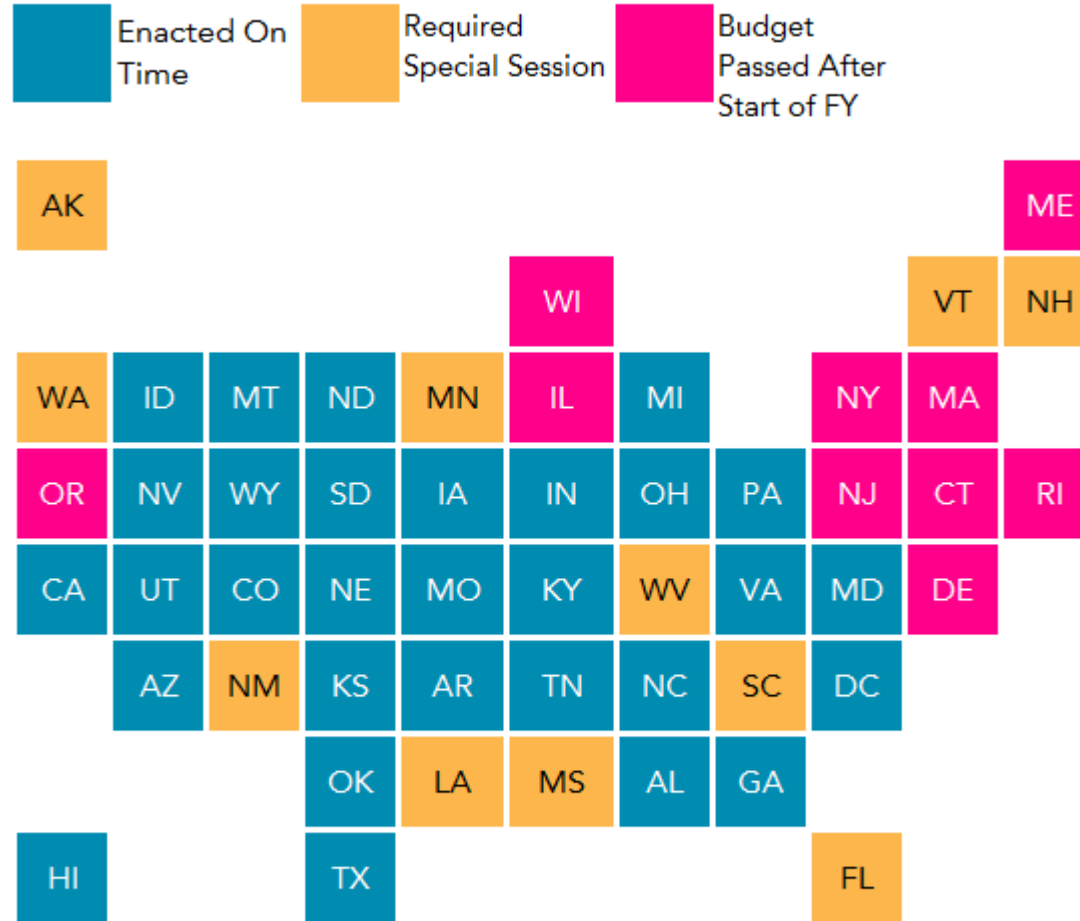


1. The state of state budgets
2. Federal changes that would affect state taxes and budgets
3. How states may respond

States had a tough time passing budgets on time



FY 2018 Budgets

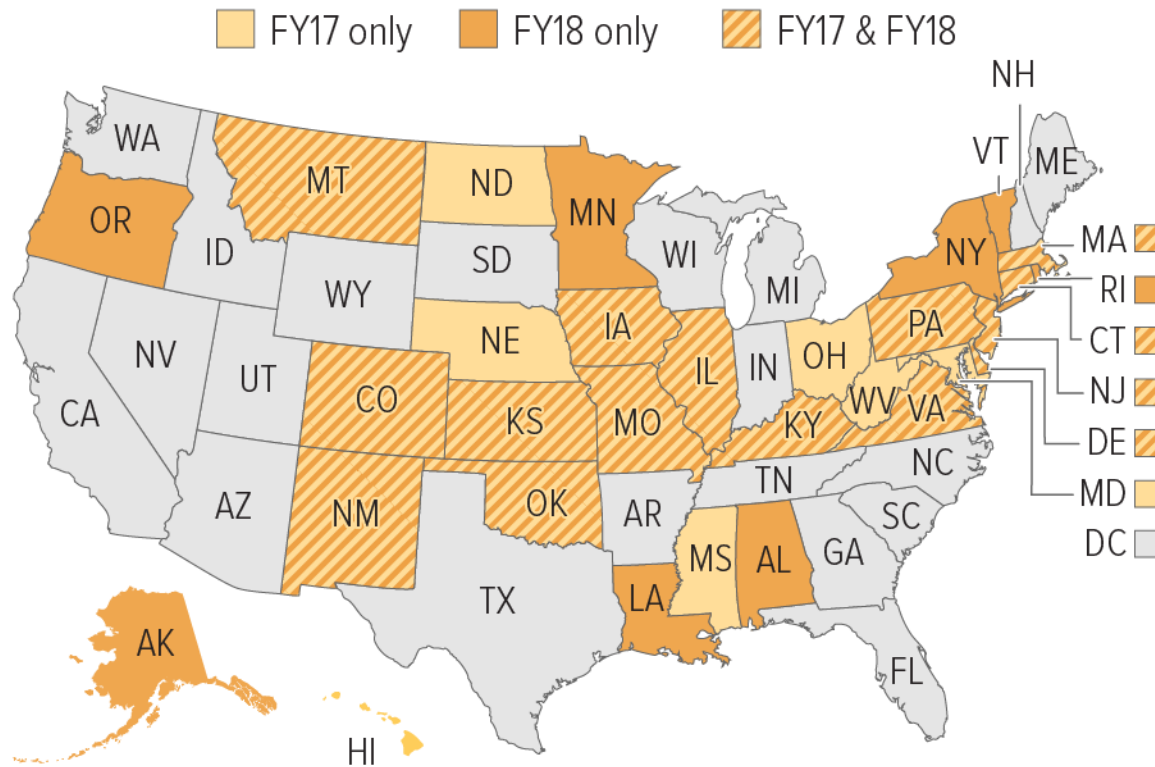


Source: National Conference of State Legislatures.

Notes: Kentucky, Virginia, and Wyoming passed biennial budgets last year. New York and Illinois passed late budgets and required special sessions.

Many states facing revenue shortfalls

30 States Addressed Revenue Shortfalls in Fiscal Years 2017 and 2018



CBPP analysis of state budget documents and news sources.

- Reluctant but needed income tax hikes: KS, IL, OK
 - After years of tax cuts
- Attempts to collect online sales tax revenue
- Gas tax increases: 23 states since 2013
 - But still politically difficult (5 rejected in 2017)
- Marijuana taxes: AK, CA, CO, MA, ME, NV, OR, WA
 - Next? DE, MD, MI, NJ, PA, SD, VT
- Estate tax repeal (DE, NJ), higher exemption (MD, NY)

- States link much of their tax systems (individual and corporate) to federal rules and definitions
- State and local tax deduction is an indirect federal subsidy to governments
- Future federal spending cuts are state cuts
 - Federal transfers are 33% of state revenue
 - About 20% of federal domestic discretionary funds goes to states

Individual provisions

- Increase the standard deduction and eliminate all personal exemptions
- Expand the child tax credit
- Repeal or limit the state and local tax deduction
 - Change the mortgage interest tax deduction(?)
- *Missing?* Base broadening. Unlike 1986 tax reform, it's not a big part of the House or Senate bill

Some things may have changed since Monday ... or last night ... or since I began this presentation



Richard Rubin ✓

@RichardRubinDC

Following



Brady on the "SALT fix," says it's not just SALT. Looking at changes in rates, brackets, AMT and family tax credit.
"All of the above."

3:01 PM - 6 Dec 2017

Standard deduction and personal exemption



Current law (tax year 2018) vs. Tax Cuts and Jobs Act				
	Single	Married	Head of Household	Personal Exemption
Current law	\$6,350	\$13,000	\$9,350	\$4,150 per taxpayer and dependents
Senate bill	\$12,000	\$24,000	\$18,000	--
House bill	\$12,200	\$24,400	\$18,300	--

- 12 states and DC link to federal standard deduction and/or personal exemption or start with federal taxable income:
 - CO, DC, ID, ME, MN, MO, NE, ND, NM, SC, UT, VT
 - *What about number of personal exemption in all states?*
- 10-20 states* and DC require filer to take state standard deduction if filer took federal standard deduction
- Federal itemizers could drop by as much as 75% because of higher standard deduction

**Don't quote me on these numbers, yet*

Expand the child tax credit



Current law (tax year 2018) vs. Tax Cut and Jobs Act					
	Max credit	Phase-out income	Refundable max	Refundable phase-in	Up to age
Current law	\$1,000	\$75,000/ \$110,00	\$1,000	\$3,000	17
Senate bill*	\$2,000	\$500,000	\$1,100	\$2,500	18
House bill**	\$1,600	\$115,00/ \$230,000	\$1,100	\$3,000	17
Rubio amendment*	\$2,000	\$250,000	\$2,000	\$0	18

*sunsets in 2026

**Plus \$300 for taxpayer, spouse, and other non-child dependents (sunsets in 2023)

States that link to federal child tax credit: CO, NY, OK

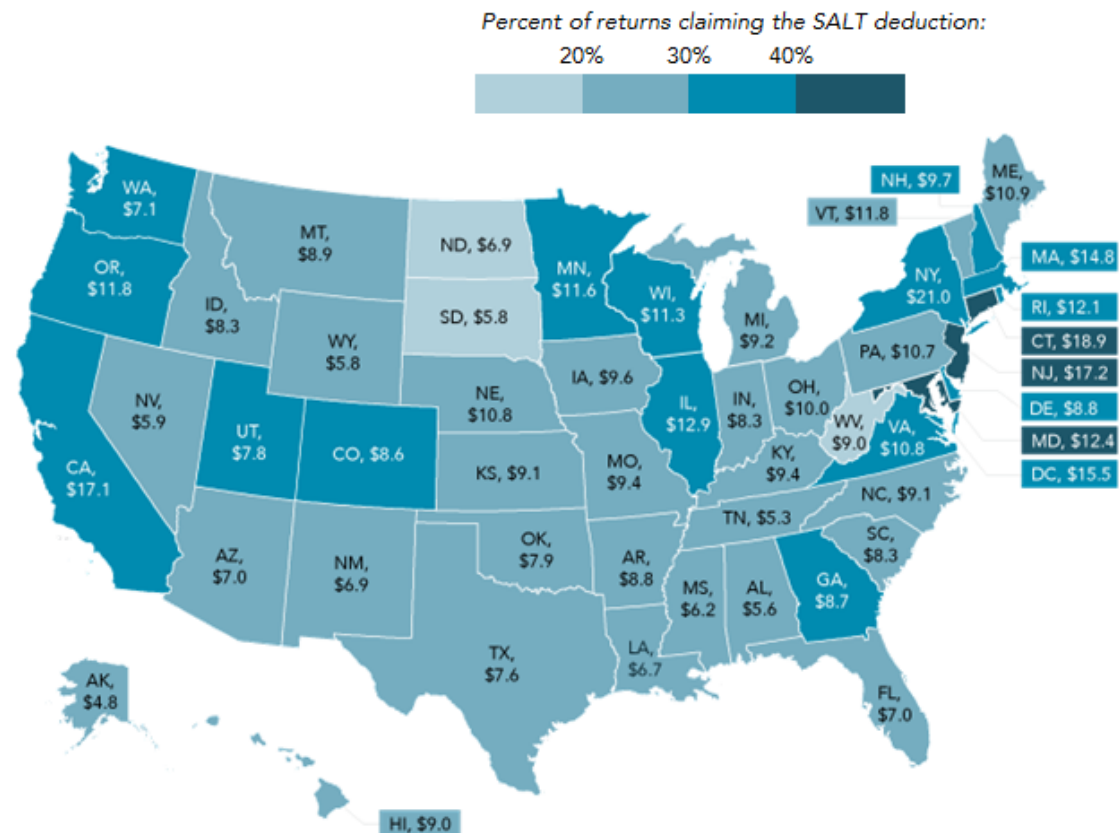
- All bills (to date) have eliminated deductions for state and local income taxes and sales taxes
- Both Senate and House bills allow deduction for up to \$10,000 in state and local property taxes
- *To date?* Now rumors that taxpayers may be allowed to deduct up to \$10,000 of either their income or property taxes (or both?)

State and local tax deduction

FIGURE 2

Returns Claiming the State and Local Tax Deduction and Average Deduction Claimed by State

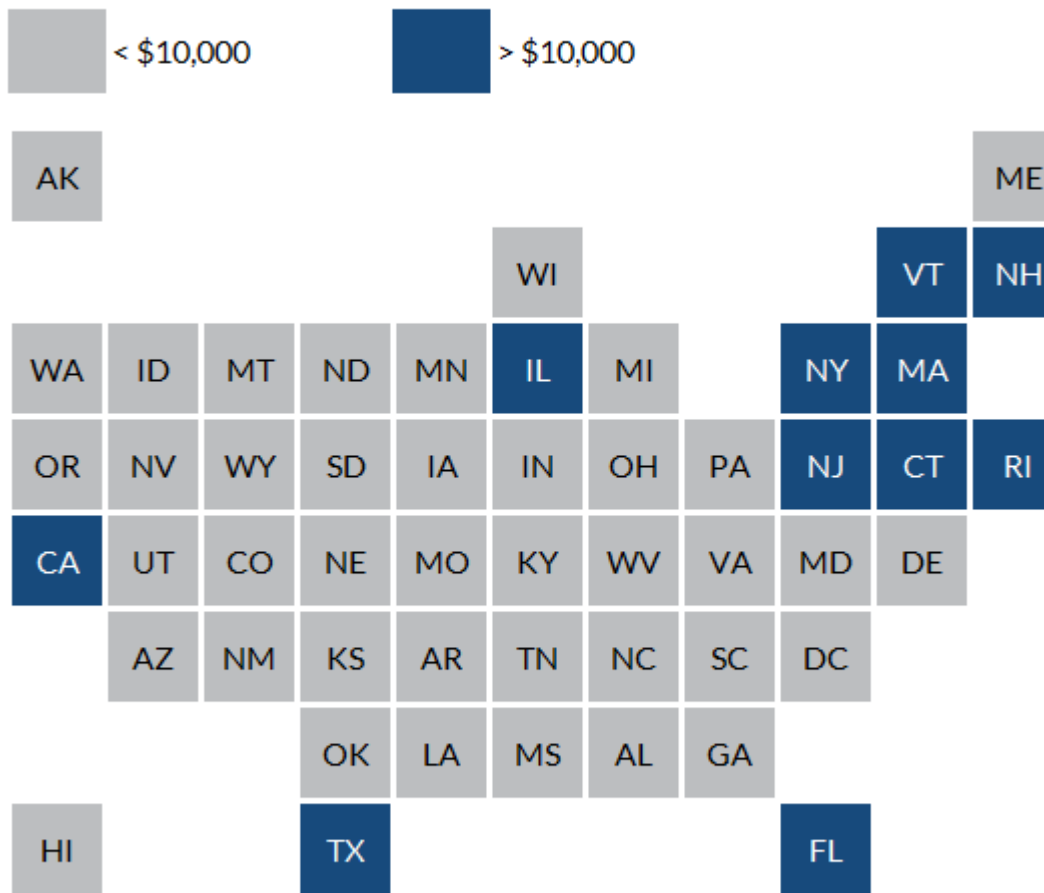
Average deduction in thousands of dollars, 2014



Source: Urban-Brookings Tax Policy Center based on data from the IRS: SOI Tax Stats - Historic Table 2. Tax Year 2014.

\$10,000 property tax deduction cap

Average Property Tax Deduction for Returns with AGI Greater than \$200,000



Source: IRS and Tax Policy Center
<http://www.taxpolicycenter.org/statistics/state-and-local-real-estate-tax-deduction-state-and-agi>

Armageddon?!



Bloomberg:

“It’s death to Democrats,” said conservative economist Stephen Moore, who advised Trump’s campaign on tax policy.

NPR:

INSKEEP: It's pretty serious. But why - well, let's talk about this tax bill. Why is this - losing this deduction so bad?

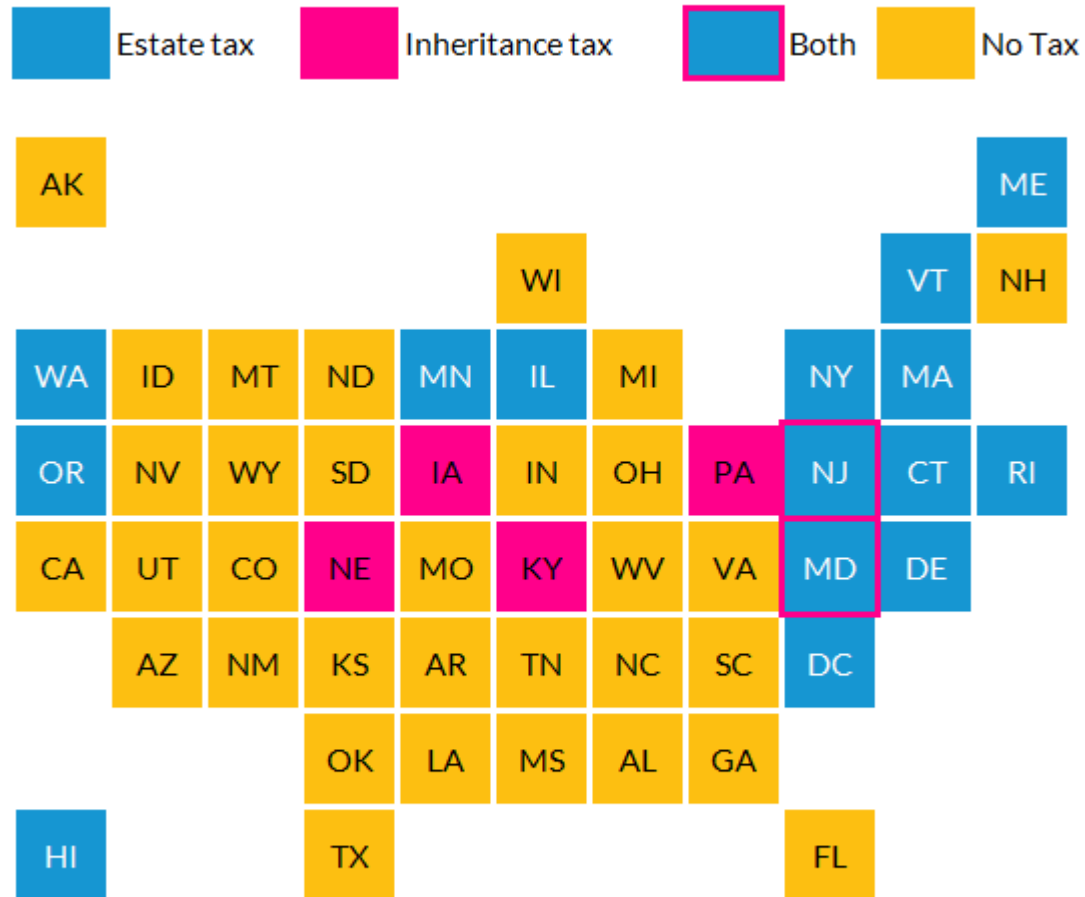
CUOMO: Well, it cripples, economically, the states that are affected. Now, it's New York. It's California. It's 12 other states. They all happen to be blue states, Democratic states with no representation in the Senate and very little in the House. And what this is doing is basically hurting the economies of those states to finance the tax cut in other states. New York, California - Finance threw away property tax and then income tax. Right now, that is deductible from your federal taxations. When they eliminate that deduction, they, in essence, raise your income tax and property tax by 20, 25 percent, which puts...

Estate tax

- House bill repeals estate tax
- Senate bill doubles estate tax exemption (sunsets in 2026)

State estate taxes

Estate and Inheritance Taxes, 2017



Source: Center on Budget and Policy Priorities.

URBAN INSTITUTE

Note: Maryland and New Jersey levy both an estate and inheritance tax. Delaware and New Jersey will repeal their estate taxes on January 1, 2018.

Business provisions

- Change from worldwide to territorial system
- 100% “bonus” depreciation (i.e., expensing) for qualified property (expires in 2023)
- Disallow interest in excess of 30% of business income
- Special “pass-through” provisions
 - House: 25% rate for passive; 35.22% for active
 - Senate: 23% deduction for qualifying pass-through business income; deduction limited above \$250,000 (single)/\$500,000 (joint); sunsets in 2026

What does it mean for states?



- Territorial system ... ???
- Bonus depreciation ... ???
 - Most states decoupled in early 2000s
 - If made permanent, states could replace corporate income taxes with gross receipts taxes
- Pass-through ... ???
 - Rate change: probably little effect on states
 - Deduction: possibly huge effect because states use federal AGI

What happens after tax reform passes?



Cost of the Senate bill over 10 years

- JCT
 - Static: \$1.4 trillion
 - Dynamic: \$1.0 trillion
- Tax Policy Center
 - Static: \$1.4 trillion
 - Dynamic: \$1.2 trillion

Where does the money come from? (probably programs that send money to states)



- Trump budget cut discretionary spending 2% each year—totaling \$1.4 trillion over 10 years
- Included double-digit percentage cuts to Agriculture, Commerce, Education, Health and Human Services, Housing and Urban Development, and Transportation
- Examples: \$200 billion cut to SNAP; \$100 billion cut to Highway Trust Fund; \$20 billion cut to TANF
- Multiple (ongoing?) efforts to cut Medicaid spending

What happens next year in state capitals?



- Do states decouple from federal policies?
 - What about policies that sunset?
- Do states lower taxes on residents to offset some of the federal tax hikes?
 - What about revenue shortfalls?
- Do states raise taxes to offset (possible) federal spending cuts?
 - If and when states raise taxes, do states opt for sales tax increases over income tax increases without SALT deduction?

THANK YOU

For more information please contact:

Richard C. Auxier
rauxier@urban.org

<http://www.taxpolicycenter.org/>

<https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative>



TAX POLICY CENTER
URBAN INSTITUTE & BROOKINGS INSTITUTION