TCJA conformity and the child tax credit (plus earned income tax credit reforms)

Revenue Stabilization and Tax Policy Committee
Santa Fe, New Mexico

July 25, 2019
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New Mexico, TCJA, and tax reform options

1. How did the Tax Cuts and Jobs Act (TCJA) affect New Mexico’s income tax system (specifically, for working families)?
2. How did New Mexico respond to the TCJA? How did other states respond to the TCJA?
3. Other reform options for the child tax credit (CTC) and the earned income tax credit (EITC)

What is tax conformity?

- All states with an individual or corporate income tax link or “conform” to federal tax rules, mostly through definitions of income
- This benefits both taxpayers (simpler) and states (regulation, guidance, compliance)
- However, conformity is always <u>a choice</u>
- States can and should “decouple” when federal rules do not fit their values or budget

Tax Cuts and Jobs Act (TCJA)

- The TCJA did <u>not</u> make significant changes to federal adjusted gross income
  - Deductions and exclusions repealed: moving expenses, alimony paid, bicycle commuting
- However, among other big changes, it <u>significantly changed</u> the standard deduction, personal exemption, and child tax credit
- This meant individual income tax conformity issues were (mostly) concentrated in a handful of states that linked to those provisions

However, the TCJA also contained other major changes

- The TCJA made numerous other changes to the federal corporate and individual income tax—many of which affected New Mexico's income tax
  - This presentation focuses on the individual tax, and particularly policies aimed at working families
- Overall, at the federal level, the TCJA:
  - Was a huge tax cut: $1.5 trillion over 10 years
  - Reduced taxes for <u>nearly all filers</u>, at all income levels
  - Provided the biggest tax cuts to high-income filers

TCJA individual income tax changes

- Increased the standard deductions
  - Single: $6,500 to $12,000
  - Head-of-household: $9,550 to $18,000
  - Married: $13,000 to $24,000
- Set the personal exemption at $0 (not repealed)
- Increased CTC from $1,000 to $2,000 per eligible child, increased max refundable amount from $1,000 to $1,400, and raised income eligibility
- Created $500 credit for non-CTC eligible dependents

Note: All these provisions sunset after Dec. 31, 2025

States that conformed before the TCJA

States That Linked to Federal Government's Standard Deductions and Personal Exemption in 2017

Standard deductions and personal exemption				
Colorado	District of Columbia	Idaho	Minnesota	Missouri
New Mexico	North Dakota	South Carolina	Utah	
Standard deductions				
Nebraska				
Personal exemption				
Maine				

Source: State statutes.

- However, none of these states conformed with the federal child tax credit
- Thus, if they did not make changes, large families in New Mexico and these other states would see state tax increases

Example family: married couple with three children, earns $50,000 in combined wage income

New Mexico taxable income: Pre-TCJA

AGI: $50,000
Standard deduction: $13,000
Personal exemptions: $20,750 ($4,150 x 5)
Taxable income: $16,250

New Mexico taxable income: Post-TCJA

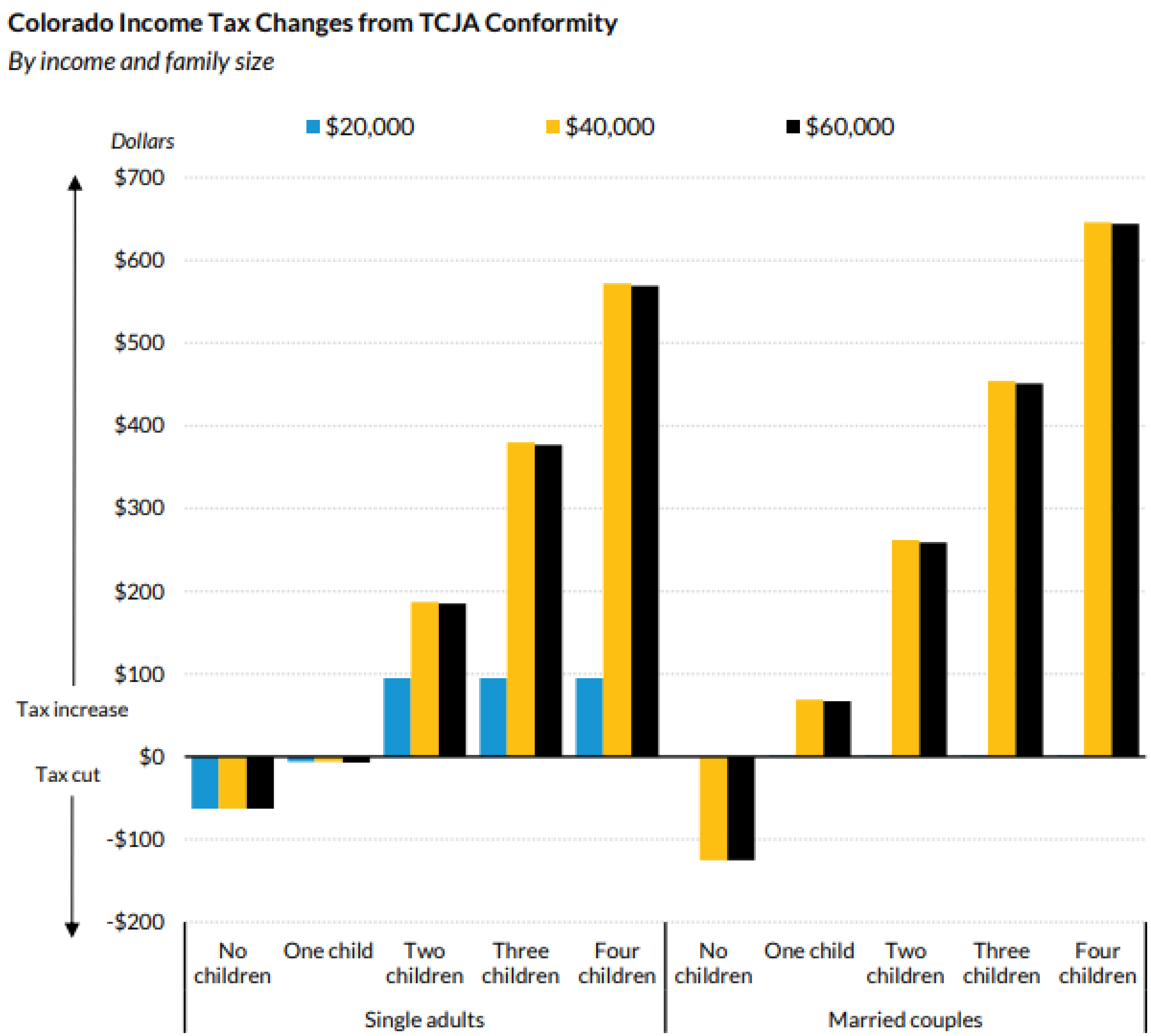
AGI: $50,000
Standard deduction: $24,000
Personal exemptions: $0
Taxable income: $26,000

At the federal level the family still gets a tax cut with larger CTC

New Mexico after the TCJA (tax year 2018)

- New Mexico made no changes to its now larger standard deductions or $0 personal exemption in 2018
- This created winners and losers ...
  - "This results in effective tax cuts or tax increases for different groups of individuals, but the people who would be most likely to see tax increases would be those with multiple dependents (e.g. children)." (LFC Hearing Brief, Aug. 22, 2018)
- And, overall, additional tax revenue ...
  - "After significant analysis, TRD determined the overall general fund revenue impact will be an increase of $54 million annually from TCJA." (LFC, Aug. 22, 2018)

What does this mean for families?
(Colorado and New Mexico faced the same problem)



New Mexico's response, 2019 session

- **Dependents deduction**: $4,000 deduction for every dependent beyond the first claimed by a taxpayer
  - I.E., two dependents equals one deduction, etc.
- **Increased the working families tax credit** (New Mexico's EITC) from 10% to 17% of the federal EITC

Benefits and challenges of New Mexico's reforms

Benefits

- Dependent deduction targeted families who were most at risk of a state tax increase
- EITC targeted families who were at risk of state tax increases *and* families who saw the least benefit from the TCJA changes

Challenges

- Dependent deduction is not tied to inflation, loses value
- Policies miss some taxpayers: deductions more valuable to higher income earners; EITC small for filers without children
- TCJA sunsets and unpredictable federal action

What did other states do?

- **Colorado, North Dakota**: No changes, maintained conformity.
- **Idaho**: Kept conformity on standard deduction and personal exemption, lowered tax rates, and created $205 CTC
- **Maine**: Created a Maine-defined personal exemption ($4,150) and $300 CTC
- **Minnesota**: Created Minnesota-defined standard deduction (new fed levels), dependent exemption ($4,250), increased Working Family Tax Credit (MN-specific EITC)
- **Vermont**: Created Vermont-defined standard deductions and personal exemption (roughly at old fed levels), increased its EITC match from 32% to 36%, and lowered some tax rates

Different responses help different taxpayers: Idaho

Idaho Tax Changes after the TCJA with and without Reforms

Tax Changes If Idaho Had Accepted the TCJA without Reforms

	Single adults					Married couples				
Earnings ($)										
20,000	-$96	$0	$0	$0	$0	$0	$0	$0	$0	$0
40,000	-$100	-$11	$284	$567	$621	-$192	$98	$295	$195	$95
60,000	-$100	-$11	$296	$603	$910	-$200	$107	$414	$722	$1,027
Number of children	0	1	2	3	4	0	1	2	3	4

Actual Tax Changes under the TCJA with Reforms

Earnings ($)										
20,000	-$134	$0	$0	$0	$0	$0	$0	$0	$0	$0
40,000	-$233	-$320	-$231	-$153	$0	-$268	-$183	$0	$0	$0
60,000	-$328	-$416	-$314	-$211	-$109	-$371	-$269	-$167	-$65	$36
Number of children	0	1	2	3	4	0	1	2	3	4

Source: Urban Institute.

Notes: TCJA = the Tax Cuts and Jobs Act of 2017. Calculations assume all income is from wage earnings.

Different responses help different taxpayers: Vermont

Vermont Tax Changes after the TCJA with and without Reforms

	Tax Changes If Vermont Had Accepted the TCJA without Reforms									
	Single					Married				
Earnings ($)										
20,000	-$48	-$1	$78	$78	$78	$1	$2	$4	$4	$4
40,000	-$48	-$1	$149	$269	$444	-$96	$57	$207	$354	$502
60,000	-$92	-$5	$142	$289	$437	-$96	$51	$199	$346	$493
Number of children	0	1	2	3	4	0	1	2	3	4

	Actual Tax Changes under the TCJA with Reforms									
Earnings ($)										
20,000	-$2	-$112	-$211	-$239	-$239	-$1	-$136	-$225	-$253	-$253
40,000	-$42	-$24	-$60	-$80	-$71	-$4	-$29	-$76	-$96	-$88
60,000	-$66	-$66	-$58	-$49	-$41	-$44	-$36	-$27	-$19	-$11
Number of children	0	1	2	3	4	0	1	2	3	4

Source: Urban Institute.

Notes: TCJA = the Tax Cuts and Jobs Act of 2017. Calculations assume all income from wage earnings.

Additional reforms New Mexico could consider if the goal is assisting working families

1. Swap dependent deduction for child tax credit
   A. Make New Mexico's CTC more progressive and/or limit its revenue costs
2. Expand working families tax credit (EITC) to childless workers
3. Expand working families tax credit (EITC) to younger workers

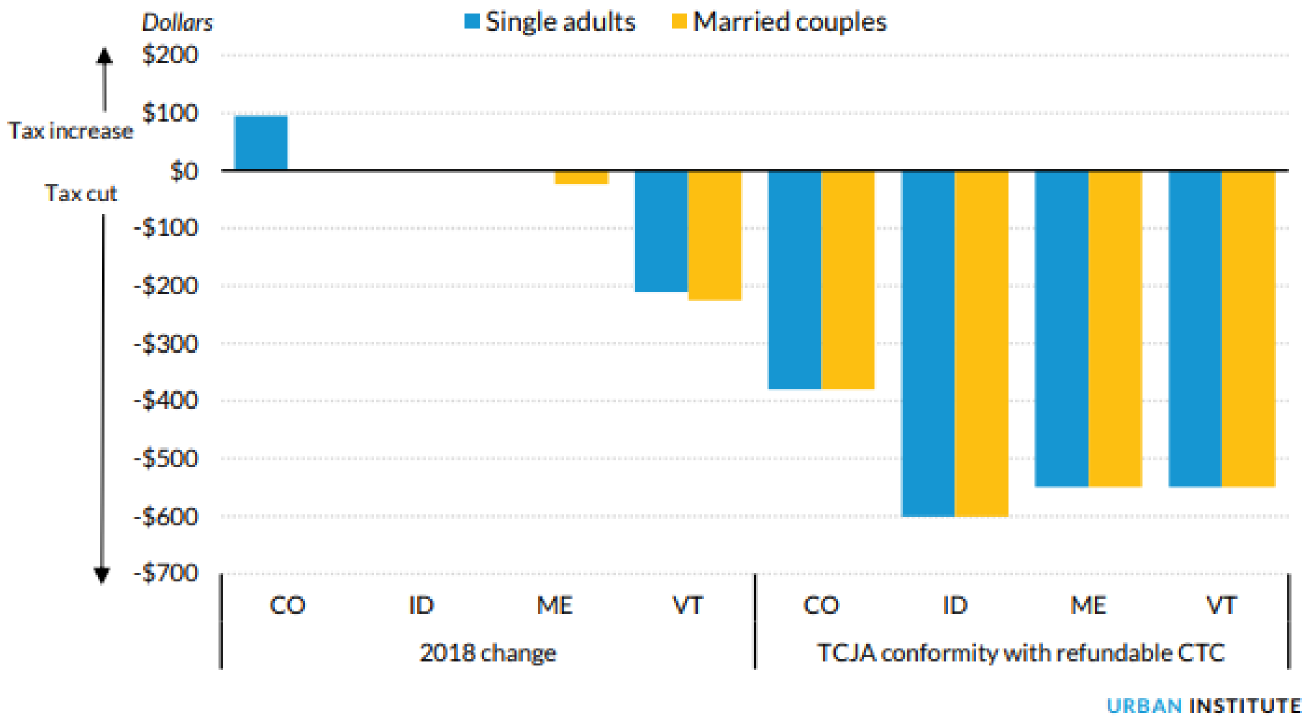
1. Create a $200 child tax credit

- Provides roughly the same value as the pre-TCJA personal exemption
- Tie credit to federal eligibility (avoids TCJA sunset)
- Simpler for taxpayers (federal return)
- Far more flexible:
  - If made refundable, would benefit far more low-income families than dependent deduction
  - Allowing all earnings in calculation would make it more generous (refundable CTC phases-in at $2,500)
  - Could phase out at lower income levels than federal credit ($200,000/$400,000) to limit cost

Targeted benefits of refundable CTC

Refundable Child Tax Credits' Reduction to Low-Income Families' Taxes

Family with two children earning $20,000



Source: Urban Institute.

Notes: Calculations assume all income comes from earnings, tax units claim the standard deduction, and all children are under age 17. The negative numbers are tax cuts, and the positive numbers are taxes. Refundable child tax credit amounts are $188 in Colorado, $300 in Idaho, $273 in Maine, and $275 in Vermont.

2. Expand the EITC to childless workers

- Increasing New Mexico's EITC from 10% to 17% delivers targeted benefits to working families
- However, it misses the same group the federal EITC misses: childless workers
  - Max federal credit is $519 (17% = $88)
- "Childless" workers include both adults without children and those with children who live the majority of the year with another parent
- Federal lawmakers from Sherrod Brown to Paul Ryan support reform ... but no federal action

Lessons from the District of Columbia's EITC reform

- District of Columbia expanded its eligible income range for childless workers beyond the federal limits
  - Maximum eligible income went from roughly $15,000 to $25,000
- District increased its EITC match for childless workers from 40% to 100%
  - Maximum credit went from $200 to $500
- Maine and Minnesota both roughly doubled their EITCs for childless workers in 2019

Lessons from the District of Columbia's EITC reform

- DC EITC claims increased 30% (nearly all from childless workers)
- Most new beneficiaries of DC EITC were full-time workers (most federal beneficiaries are part-time)
- Most childless beneficiaries are younger (ages 25-30) and a plurality are male (plurality of claimants with children are female)
- No administrative problems
- Cost only $8 million (less than 0.1% of general revenue)

3. Expand the EITC to younger workers

- Currently, you must be 25 years old to claim the federal EITC if you do not have children
- California, Maine, and Maryland make residents ages 18 to 24 eligible for their state EITC, even without qualifying children

Big takeaway: Uncertainty

- Nearly all individual income tax provisions in the TCJA expire after 2025
- The TCJA is a partisan bill (unlike TRA 1986)
- No matter how New Mexico decides to proceed, legislators need to keep an eye on Washington
- Conformity is still often beneficial, but you cannot assume laws won't change
- Probably beneficial to achieve policy goals without federal conformity

THANK YOU

For more information please contact:

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