Federal Tax Changes and New Mexico's Response

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Introduction to ITEP

The **Institute on Taxation and Economic Policy** (ITEP)

Non-profit

Non-partisan research organization

Federal, state, and local tax policy issues

Mission:

Ensure elected officials, media, and general public have access to accurate, timely, and straightforward information that allows them to understand the effects of current and proposed tax policies with an emphasis on tax-incidence analysis.

Implications of TCJA for NM Tax Law

New Mexico Tax Changes

- New Mexico bases its income tax on federal adjusted gross income and couples to federal deductions and personal exemptions

9.	**FEDERAL ADJUSTED GROSS INCOME.** (from federal Form 1040, line 38; Form 1040A, line 22 or Form 1040EZ, line 4)		9
10.	If you itemized your federal deduction amount, enter the amount of state and local tax deduction claimed on federal Form 1040, Schedule A, line 5. See the worksheet in the instructions	+	10
11.	Total Additions to federal adjusted gross income (PIT-ADJ, line 5). **Attach PIT-ADJ.**	+	11
12.	Federal standard or itemized deduction amount (from federal Form 1040, line 40; Form 1040A, line 24; or Form 1040EZ, line 5)	-	12
12a.	If you **itemized,** mark the box. 12a ☐		
13.	Federal exemption amount (from federal Form 1040, line 42; Form 1040A, line 26; or if you filed Form 1040EZ, leave blank)	-	13
14.	New Mexico low- and middle-income tax exemption. See PIT-1 instructions	-	14
15.	Total Deductions and Exemptions from federal income (PIT-ADJ, line 22). **Attach PIT-ADJ**	-	15

- Conformity to federal changes automatic unless action taken otherwise

New Provisions & Impact on State Budget

- You lose some, you win some…

- Revenue losses/Tax cuts
  - Itemized deductions
    - Elimination of PEASE disallowance
  - Increased standard deduction (almost doubled for all filer types)

New Provisions & Impact on State Budget

- Revenue gains/Tax increases
  - SALT cap
  - Eliminating federal personal exemption
  - Eliminating NM low- and moderate-income personal exemption
  - Permanent adoption of "chained CPI" as federal inflation measure

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New Provisions & Impact on State Budget

Incidence analysis: Eliminating Federal Personal Exemption

State Tax Change for Residents ($1000)
+203,000

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $19,000	$19,000 – $35,000	$35,000 – $55,000	$55,000 – $92,000	$92,000 – $178,000	$178,000 – $402,000	$402,000 – Or More
Average Income in Group	$12,000	$28,000	$44,000	$70,000	$123,000	$247,000	$973,000
Personal Exemption Elimination (Federal Only)							
Tax Change as % of Income	+0.01%	+0.2%	+0.4%	+0.5%	+0.4%	+0.2%	+0.1%
Average Tax Change	+1	+49	+178	+379	+545	+481	+721

New Provisions & Impact on State Budget

Increased Standard Deduction Does Not Offset Loss of Personal Exemptions for Most Families with Children					
	Current Standard Deduction	TCJA Standard Deduction	Increase in Standard Deduction	Loss of Personal Exemptions ($4150 per person)	Change in Taxable Income
Married Filing Joint					
no children	$13,000	$24,000	$11,000	$8,300	-$2,700
1 child	$13,000	$24,000	$11,000	$12,450	**+$1,450**
2 children	$13,000	$24,000	$11,000	$16,600	**+$5,600**
Head of Household					
1 child	$9,550	$18,000	$8,450	$8,300	-$150
2 children	$9,550	$18,000	$8,450	$12,450	**+$4,000**
Single	$6,500	$12,000	$5,500	$4,150	-$1,350

New Provisions & Impact on State Budget

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New Provisions & Impact on State Budget

- Ambiguous state statutory language when it comes to personal exemptions that tie eligibility to federal exemptions

7-2-5.8. Exemption for low- and middle-income taxpayers.

A. An individual may claim an exemption in an amount specified in Subsections B through D of this section not to exceed an amount equal to the number of federal exemptions multiplied by two thousand five hundred dollars ($2,500) of income includable, except for this exemption, in net income.

- The consensus in states is mixed
  - MI and MO interpreted their statues as eliminating state exemptions
  - MD lawmakers disagreed as to effect so just changed language to clarify it wasn't impacted

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New Provisions & Impact on State Budget

- Revenue gains/Tax increases
  - SALT cap
  - Eliminating federal personal exemption
  - Eliminating state low- and moderate-income personal exemption
  - **Permanent adoption of "chained CPI" as federal inflation measure**

New Provisions & Impact on State Budget

- Net Impacts of Combined PIT Changes

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $19,000	$19,000 – $35,000	$35,000 – $55,000	$55,000 – $92,000	$92,000 – $178,000	$178,000 – $402,000	$402,000 – Or More
Average Income in Group	$12,000	$28,000	$44,000	$70,000	$123,000	$247,000	$973,000
Combined State-Level Effects *Assuming Federal Personal Exemption Eliminated*							
Tax Change as % of Income	+0.005%	–0.05%	+0.01%	+0.08%	+0.1%	+0.1%	+0.07%
Average Tax Change	+1	–13	+6	+53	+145	+355	+643
% with Income Tax Cut	7%	44%	52%	52%	47%	31%	22%
Avg. Tax Cut for Those w/ Cut	–1	–32	–48	–84	–122	–230	–421
Share of resident tax cut	0.1%	10%	16%	31%	30%	10%	3%
% with Income Tax Increase	31%	21%	18%	36%	50%	66%	77%
Avg. Tax Increase for Those w/ Increase	+2	+5	+176	+268	+405	+641	+955
Share of resident tax increase	0.2%	0.2%	7%	24%	38%	21%	9%

State Tax Change for Residents ($1000)
+46,000

% of Taxpayers w/Cut	39%
% of Bottom 80% with Cut	39%
% of Top 20% with Cut	42%
% of Taxpayers w/Increase	32%
% of Bottom 80% with Increa	26%
% of Top 20% with Increase	55%

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New Provisions & Impact on State Budget

- Net Impacts of Combined PIT Changes

	State Tax Change for Residents ($1000)
	+46,000
Returns, 0 Children	—
Returns, 1 Child	+8,000
Returns, 2 Children	+20,000
Returns, 3 Children	+12,000
Returns, 4+ Children	+6,000

Responses to TCJA

Range of Responses

- Strategy #1: Do nothing—accept the tax increase on New Mexico taxpayers and higher revenues for the state
- Strategy #2: Decouple from federal tax code
- Strategy #3: Remain coupled to some provisions and decouple from others
- Strategy #4: Stay coupled and create an offsetting cut
    - How much?
    - Who?

Recommendations for Thinking Through the Issue of How to Respond

- Opportunity for evaluation of state tax system
  - Narrow, immediate view: Do we want to stay coupled to these changes and whether/how to hold taxpayers harmless?
  - Broad, longer-term view: How much do we want to rely on the federal tax code? Is our tax code on the best path to serve the long-term needs of our state? How might the changes we want to make in response to TCJA relate to conversations we've already been having about tax reform?

Principles for Response

- Response should be
  - Informed
  - Holistic (not responding to a particular tax change such as the SALT cap)
  - Conservative (account for uncertainties in estimates)
  - Take the long view regarding adequacy of state revenues to meet current and future needs
  - Promote tax equity

Principles for Response: Adequacy

- State needs adequate taxes to invest in its people and infrastructure

- Context
  - Looming federal budget cuts
    - Medicare, Medicaid, SNAP, non-defense discretionary funding (transportation and infrastructure, education and training, medical research, child and elder care, environmental protection, other)
    - Loss of federal grants-in-aid to state govts and increase the burden on states to provide services

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Principles for Response: Adequacy

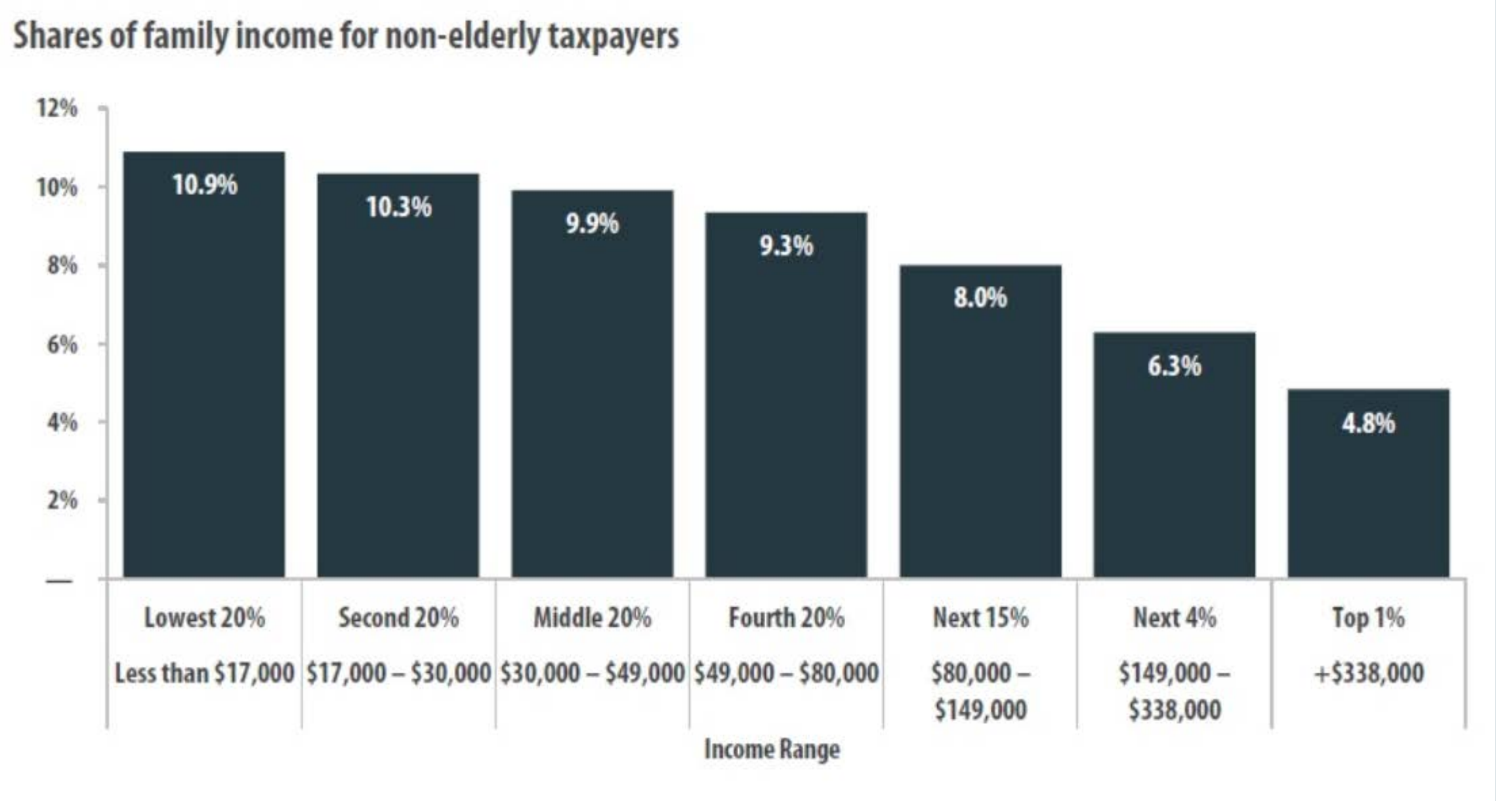
- Context cont'd
  - Adequacy of current state revenues
    - Recovering from years of budget cuts and crises
      - Demand rising among neighboring states (AZ, CO)
    - Rainy day funds?

Principles for Response: Adequacy

- Implications:
  - Reject any efforts to worsen your budget outlook through net cuts—particularly those that are permanent in nature and don't promote broad economic opportunity
  - Don't be like:
    - Georgia
    - Iowa
    - Idaho
    - Utah
    - Missouri

Principles for Response: Tax Equity

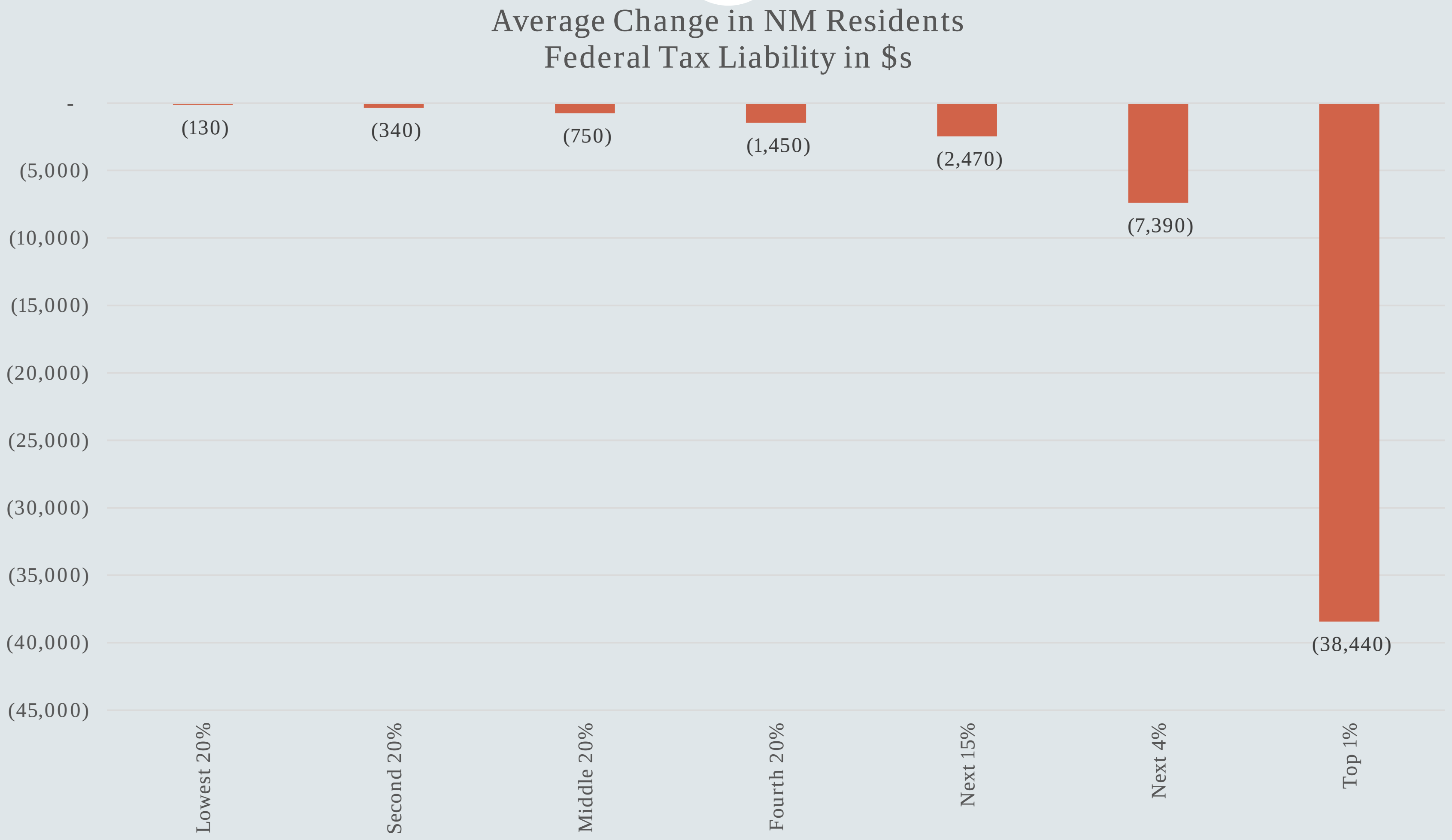
- New Mexico's state and local tax system is regressive



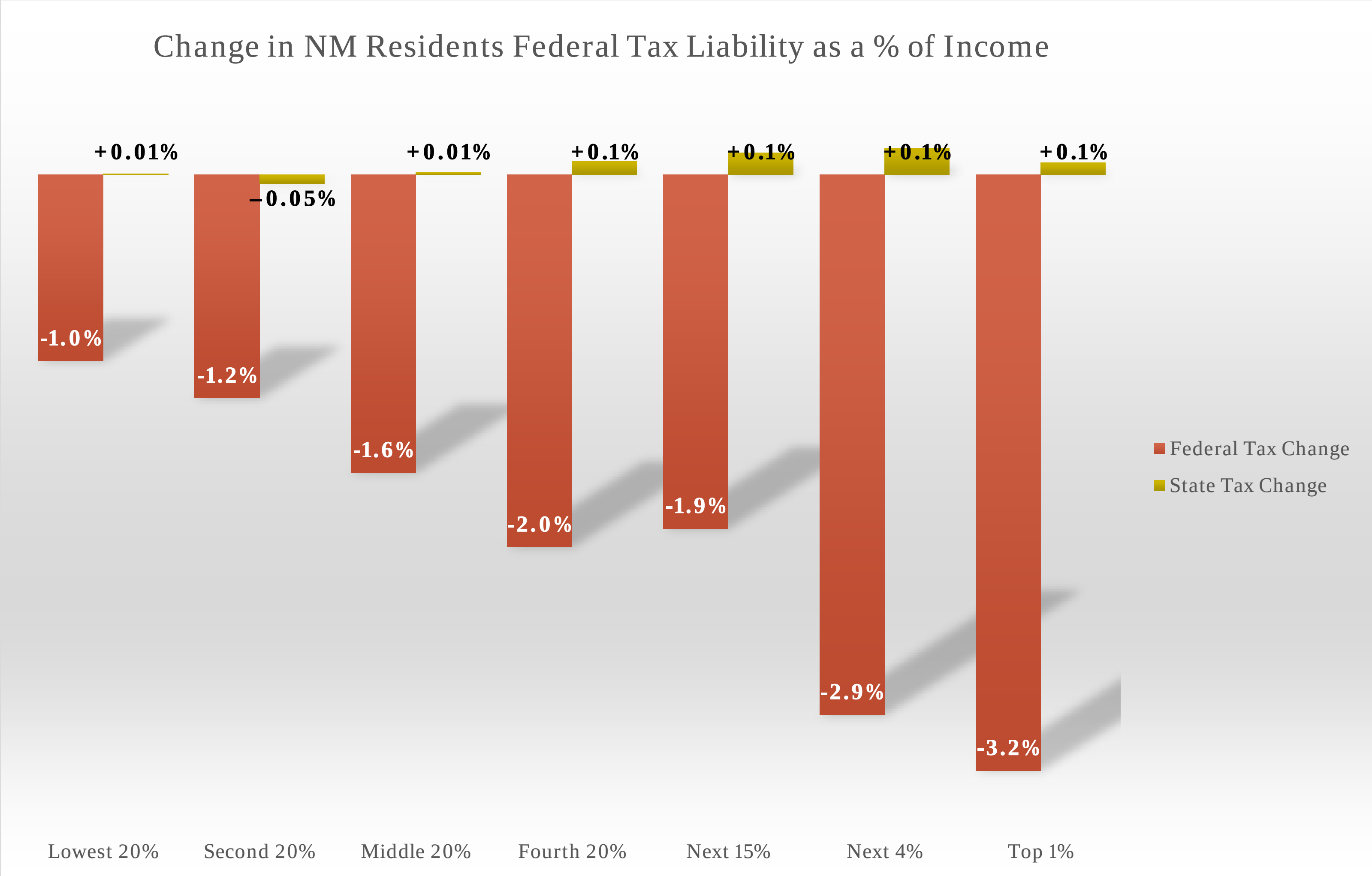
Principles for Response: Tax Equity

- Highest-income residents of every state received federal tax cuts that far exceed the cuts going to low- and middle-income families
- Federal tax cuts received far outweigh any state-level tax increases they might see as an effect of conformity

Principles for Response: Tax Equity



Principles for Response: Tax Equity



Principles for Response: Tax Equity

- Implications:
  - If you're going to cut taxes in response to federal tax reform, mitigate—don't exacerbate—the regressive nature of federal tax changes that overwhelmingly benefited the highest-income Americans
  - Preferred mechanisms:
    - Decouple from federal personal exemption repeal (i.e., retain)
    - Bolster targeted tax cuts for low- and middle-income families
      - Especially important in light of tax increases due to change in inflation standard

Recommendations

Scenario 1: Offset Tax Increase from Conformity

Need to answer the question of how much to offset?

- Option 1
  - Decouple from federal deduction and exemption changes
    - Enact standalone provisions (MI, SC personal exemption)
    - Couple to an earlier version of federal tax law
- Option 2
  - Bolster state low- and middle-income exemption (increase value, expand eligibility)

Scenario 1: Offset Tax Increase from Conformity

- Option 3
  - Bolster state EITC
  - Targeted for families with children—the group most impacted by federal conformity changes
  - Increase from 10% to 20% of federal
    - Cost: ~$55 million
    - On average, holds harmless all taxpayers in bottom 80% from tax increases due to federal conformity

Scenario 1: Offset Tax Increase from Conformity

- Option 4
  - Create a state Child Tax Credit
  - Targeted for families with children
    - Addresses child poverty: NM is worst in nation
    - Addresses negative impacts for families with kids negatively impacted by TCJA
  - $100 refundable credit, $45 million, 76% of cut goes to bottom 80%
  - NM Voices for Children proposal for refundable credit scaled to income ($175 max. phased down to $25), $67 million, 72% of cut goes to households with AGI below $50,000

Scenario 2: Conformity in Context of Broad Tax Reform

- Reform Agenda
  - GRT:
    - Broaden the base by repealing wasteful and ineffective carve-outs
    - Lower the state rate
    - LICTR: increase and modernize
    - Expand full GRT to internet sales
  - Reduce reliance on extremely volatile income sources like receipts from oil and gas
    - ***Over the long term, <u>progressive</u> income taxes are the most reliable revenue source available to states, displaying more robust growth than sales, property, or excise taxes***

Scenario 2: Conformity in Context of Broad Tax Reform

- Reform Agenda, cont'd
  - Promote more broad-based economic opportunity by reducing taxes of low- and middle-income households and increasing the share of taxes paid by the wealthy
    - Eliminate the capital gains exclusion
    - Repeal 2003 rate/bracket cuts
  - Bolster corporate income tax
    - Consider increasing CIT rates
    - Strengthen combined reporting
    - Especially important with move to federal territorial system

Questions?

Thank you for your time and attention!

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