TPC TAX POLICY CENTER
URBAN INSTITUTE & BROOKINGS INSTITUTION

Post-Pandemic State Tax Cuts

New Mexico Revenue Stabilization and Tax Policy Committee

August 2022

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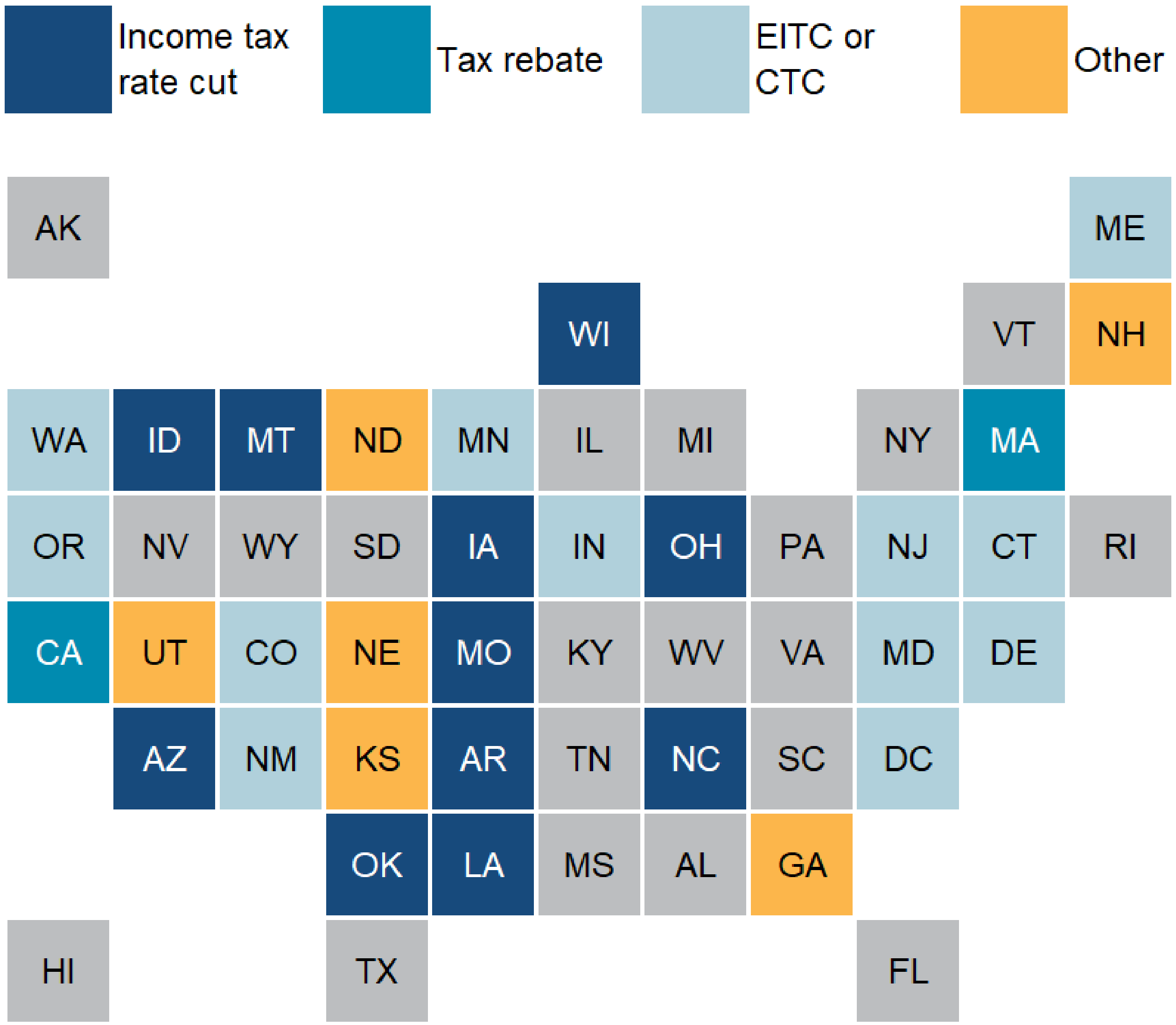
Overview

- Two years of state tax cuts
- Why did so many states cut taxes?
- What groups benefited from different types of state tax cuts?
- What are the pros and cons of various state tax cuts?
- What comes next?

Two years of state tax cuts

State Tax Cuts in 2021

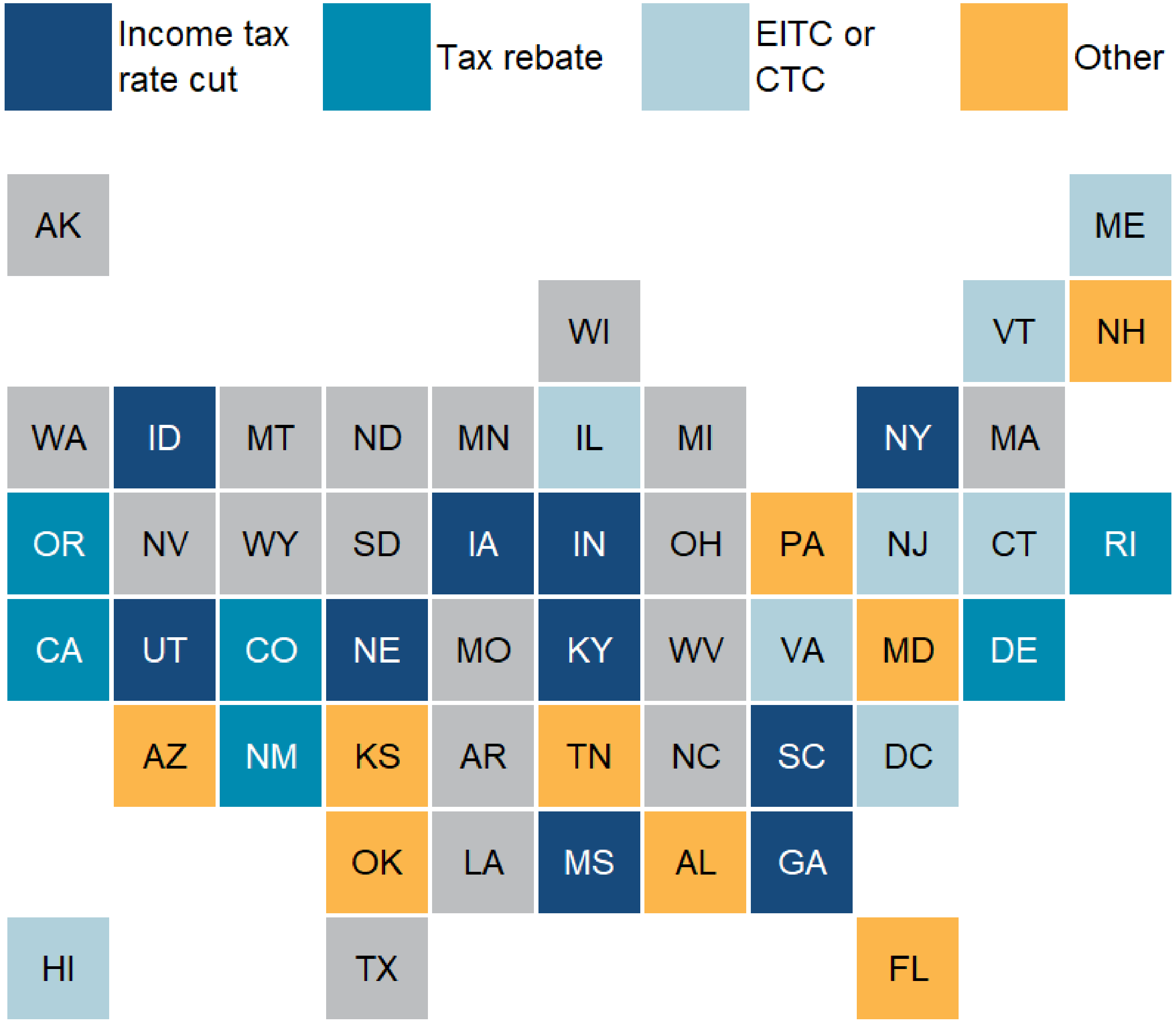


Source: Autor's count based on media stories.

30 states and DC passed a significant tax cut in CY 2021

- 11 states cut income tax rates
- 13 states & DC created/expanded EITC
  - CO was only state to create a CTC
- 4 states sent one-time tax rebates
- "Other" tax cuts included expanding an income tax deduction or credit (other than EITC or CTC), lowering corporate or business taxes, and property tax relief
- Many states passed multiple types of tax cuts (e.g., Maryland expanded its EITC and sent tax rebates)

State Tax Cuts in 2022



Source: Autor's count based on media stories.

33 states and DC passed a significant tax cut in CY 2022*

- 10 states cut income tax rates
- 6 states & DC created/expanded an EITC and 3 states created a CTC
- 15 states sent one-time tax rebates
- "Other" tax cuts included grocery tax repeals, gas tax suspensions, lowering corporate or business taxes, and property tax relief
- Numerous states passed multiple types of tax cuts (e.g., Georgia cut income tax rates and sent tax rebates)

**As of August 10, 2022*

Why did so many states cut taxes?

Three major drivers of state tax cuts

1. Federal government's response to the COVID-19 pandemic
2. The pandemic's unequal economic consequences
3. A shift to purchasing (taxable) goods instead of (nontaxable) services

… plus a few other factors worth keeping in mind

Federal government's response to the pandemic

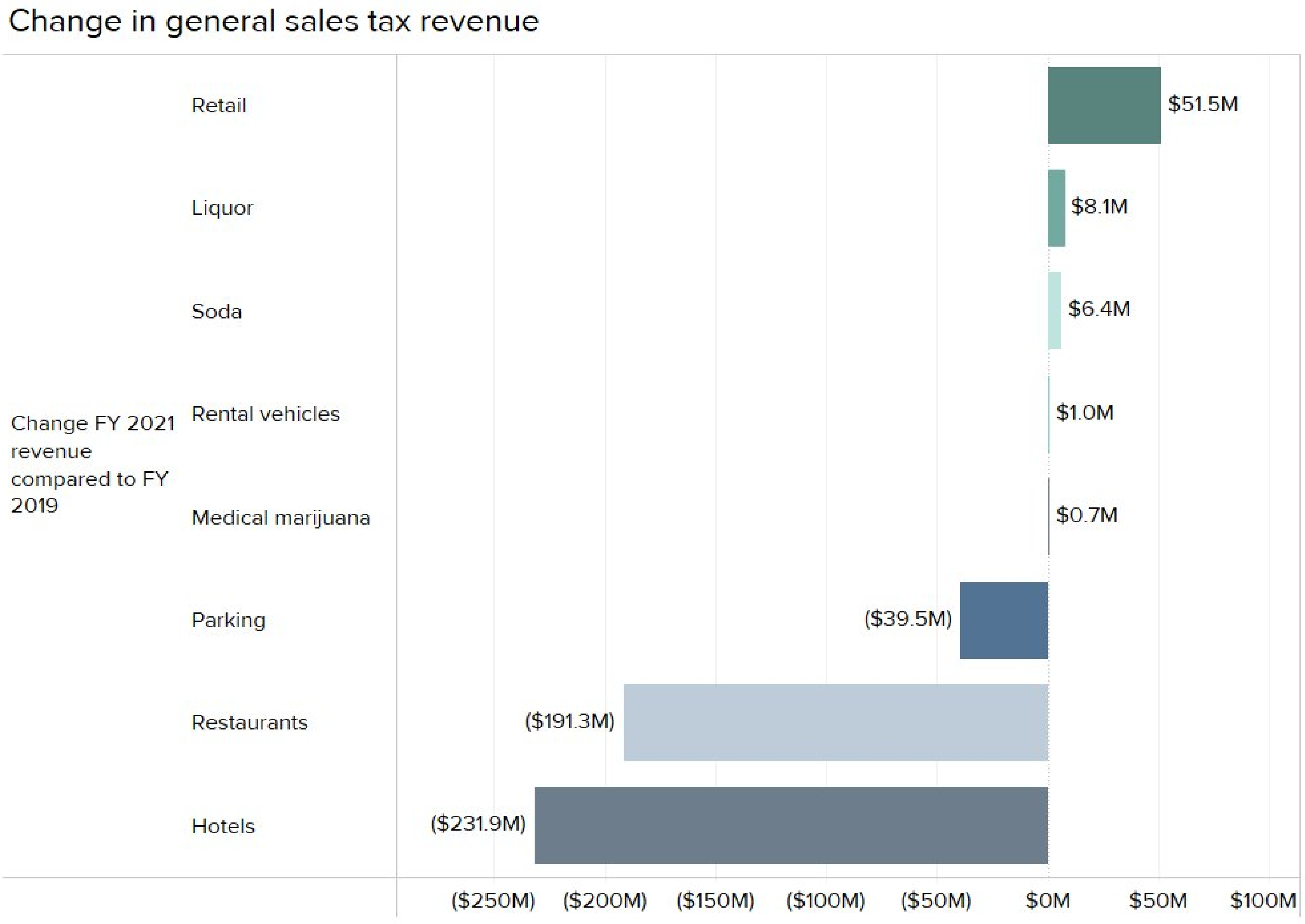
- Unprecedented federal action included multilple stimulus checks, expanded unemployment benefits, and advanced child tax credit payments
  - This put money directly in the hands of Americans who made (taxable) purchases despite high unemployment and other economic challenges
  - It also drove a strong and quick economic recovery. The US unemployment rate fell from 14.7% in April 2020 (peak) to 5.9% in June 2021 and now 3.6% in June 2022
- Congress also authorized roughly $880 billion in direct pandemic-related funds for state and local governments from March 2020 to March 2021
  - This meant strong own-source state collections piled on top of generous federal transfers, creating revenue surpluses even as states spent significantly on programs and services

The pandemic's unequal economic consequences

- During the pandemic, many low-income workers lost their jobs (e.g., service sector workers) while high-income workers generally worked from home and kept or increased their incomes
  - For example, comparing January 2020 to August 2021, the US had nearly 25% fewer jobs paying less than $27,000 a year but roughly 10% more paying over $60,000
- The stock market also saw strong growth for most of calendar year 2020 and 2021
- Because states rely more on high-income households than low-income households for tax collections (in aggregate) state tax collections were strong despite other challenges
  - And particularly so in states with progressive income tax rates

Consumption shifts

- Americans increasingly purchased goods during the pandemic
  - This was good for states that levy a general sales tax because goods (e.g., cleaning supplies) are typically subject to sales tax while services (e.g., home cleaning) are not
    - *Further, the* Wayfair *decision (2018) meant surging online purchases were also taxed*
- Conversely, Americans purchased fewer services, particularly those related to travel, dining out, and entertainment
  - These declines typically do not affect state collections but were (and still are) bad for local governments that rely on taxes related to nightlife, events, and tourism
    - *This type of consumption (and tax) is returning somewhat in 2022*



Source: D.C. OCFO Budget Books, various years

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The Alice M. Rivlin Initiative

District of Columbia Tax Collections

- Graph shows FY 2021 vs. FY 2019
- General sales tax ("retail") collections increased (top bar)
- However, revenue from taxes on parking, restaurants, and hotels decreased (bottom three bars)
- DC is illustrative because it collects both state-level and local-level taxes

Other factors: Budget quirks

- **Tax shifting.** In the spring of 2020, both the IRS and state tax agencies pushed income tax filing deadlines from April to July. This “shifted” a lot of revenue (that was going to be collected, regardless) from FY 2020 (April) to FY 2021 (July).
  - As a result, FY 2020 collections looked worse and FY 2021 collections looked better
  - This may have fueled some state tax cuts
  - However, state tax collections were strong in FY 2021 with or without the shift and remained strong in FY 2022
- **Baselines.** According to NASBO, many states reduced spending when preparing FY 2021 budgets (in spring 2020) in response to the pandemic
  - This may have contributed to FY 2021 surpluses and thus also prompted state tax cuts
  - However, again, state tax collections were high in FY 2021 and 2022, no matter the baseline

Other factors: Severance taxes

- Severance taxes (i.e., taxes on the extraction of natural resources such as oil and natural gas) typically account for more than 5% of general revenue in only four states …
  - But New Mexico is one of those states
- Significant increases in oil prices and productions have produced huge tax collections in New Mexico, Alaska, Texas, and Wyoming
- However, as always, severance tax revenue is inherently volatile, and flexible budgets and generous rainy day funds are strongly encouraged for these states

Who benefited from different state tax cuts?

Distributional analysis

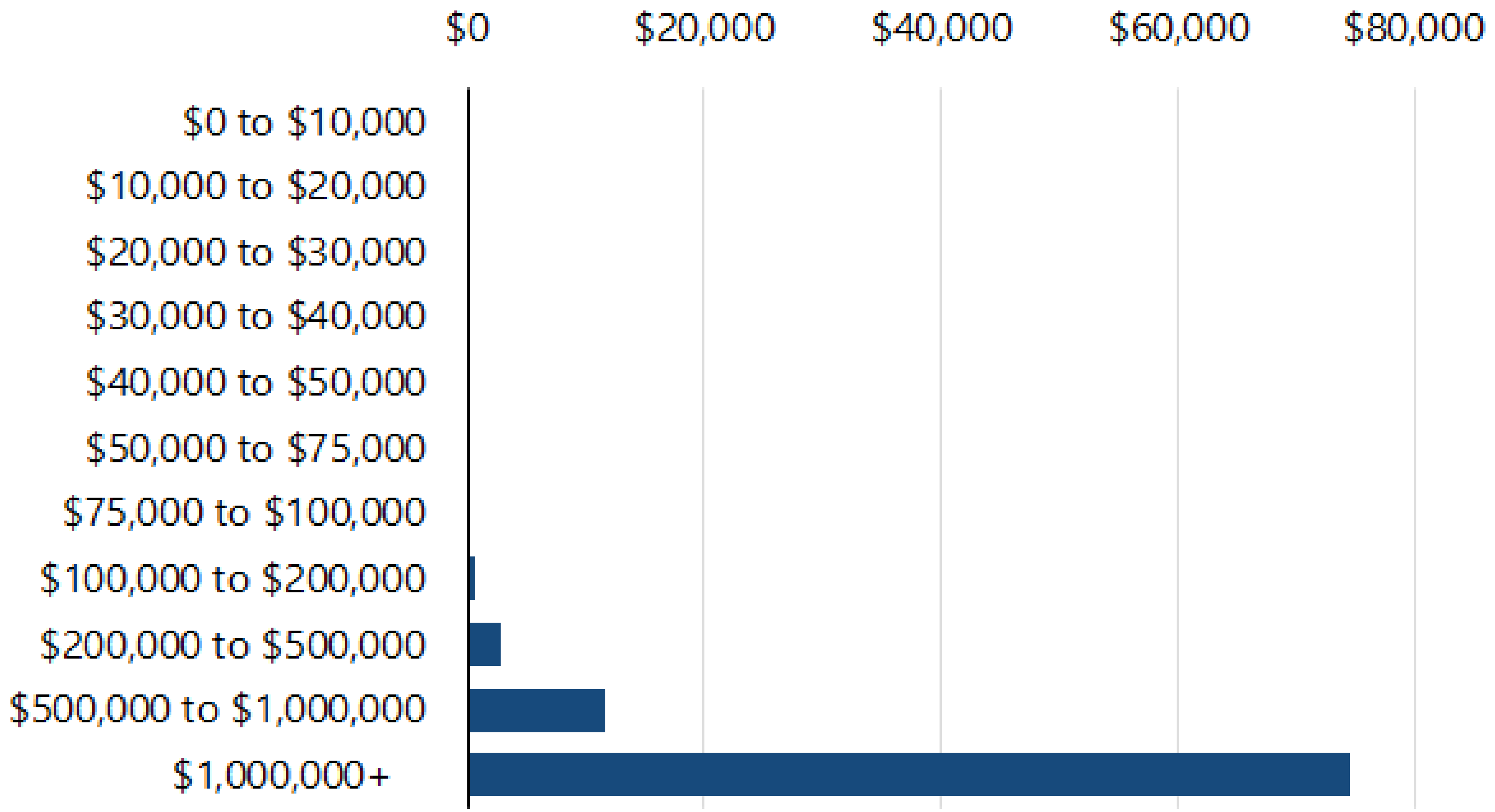
- Using the Tax Policy Center's state tax model, we examined several state tax cuts in CY 2021 and 2022, including
  - Individual income tax rate cuts
  - One-time tax rebates
  - Earned income tax credits (EITC) and child tax credits (CTC)
- I will use the term "average tax cut" in this presentation for simplicity. However, all distributional data shows "average net change." That is, it accounts for filers who did and *did not* receive a tax cut. Thus, in most cases, the "average tax cut" for those who got a tax cut is higher. But we want to examine a state's full population
- Additionally, TPC cannot model sales tax changes but I will discuss them later in the presentation

Income tax rate cuts

- An income tax rate cut is either lowering a tax rate or eliminating an income tax bracket
- In some states the income tax rate cuts are phased-in over multiple years, and in some of those states future rate reductions are tied to revenue “triggers”
- Arkansas, Arizona, Georgia, Idaho (twice), Indiana, Iowa (twice), Kentucky, Louisiana, Mississippi, Missouri, Montana, Nebraska, New York, North Carolina, Ohio, Oklahoma, South Carolina, Utah, and Wisconsin passed an income tax rate cut in CY 2021 or 2022

Average Annual Arizona Tax Cut (2021)

By adjusted gross income group

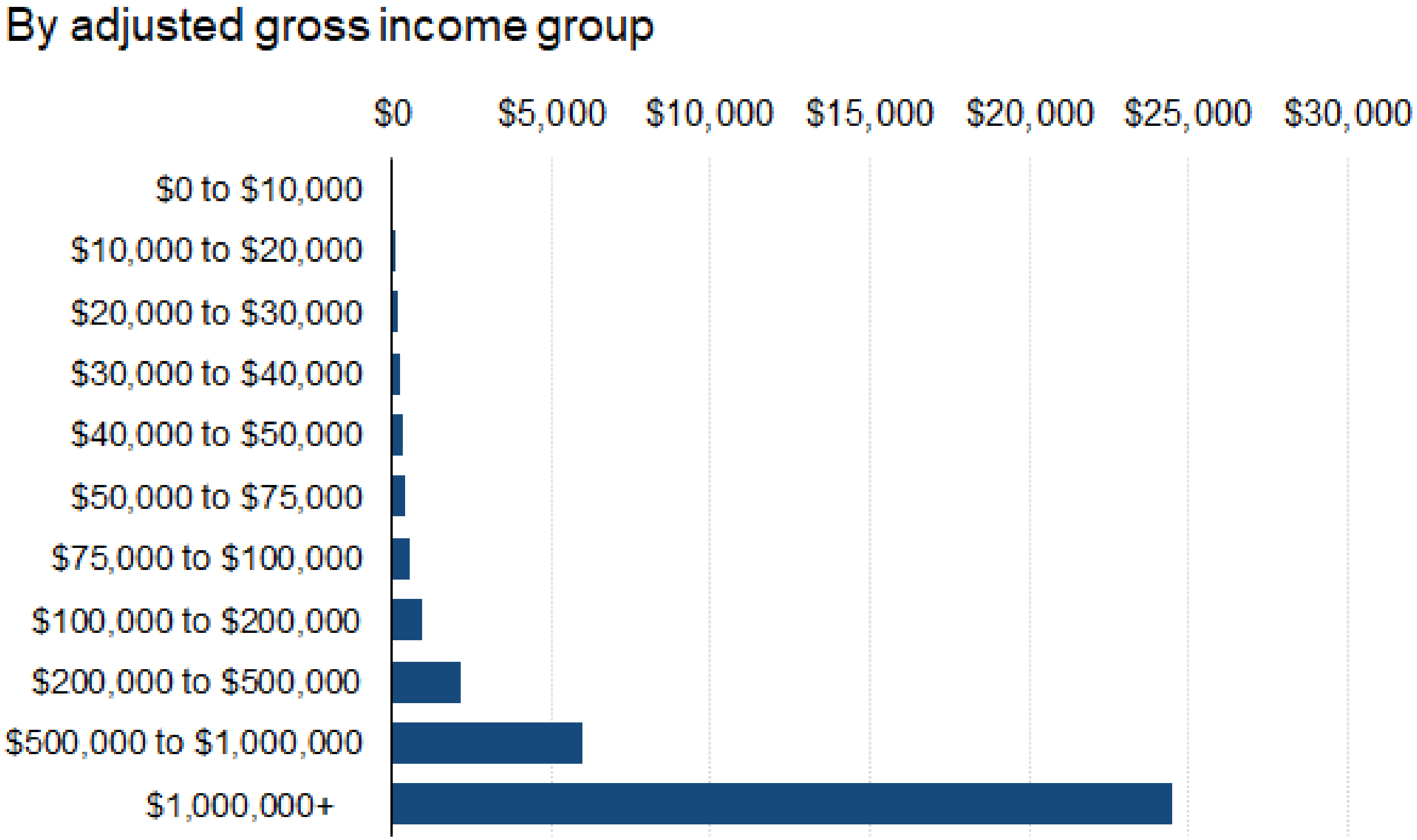


Source: Tax Policy Center state tax model.
Note: Results show benefits when Arizona's tax cuts are fully phased in. "Average annual tax cut" accounts for both residents who will get a tax cut from the legislation and those who will not.

Arizona's tax cut

- Lowered top rate ($250,000+) from 8% to 4.5%
- Reduced number of tax brackets from 5 to 2
- Some tax cuts phased-in but we show effect of changes when fully implemented
- Average tax cut for households earning between $30,000 and $100,000 range from $10 to $200
- Most households earning less than $30,000 get no tax cut because they have no taxable income

Average Annual Mississippi Tax Cut (2022)



Mississippi's tax cut

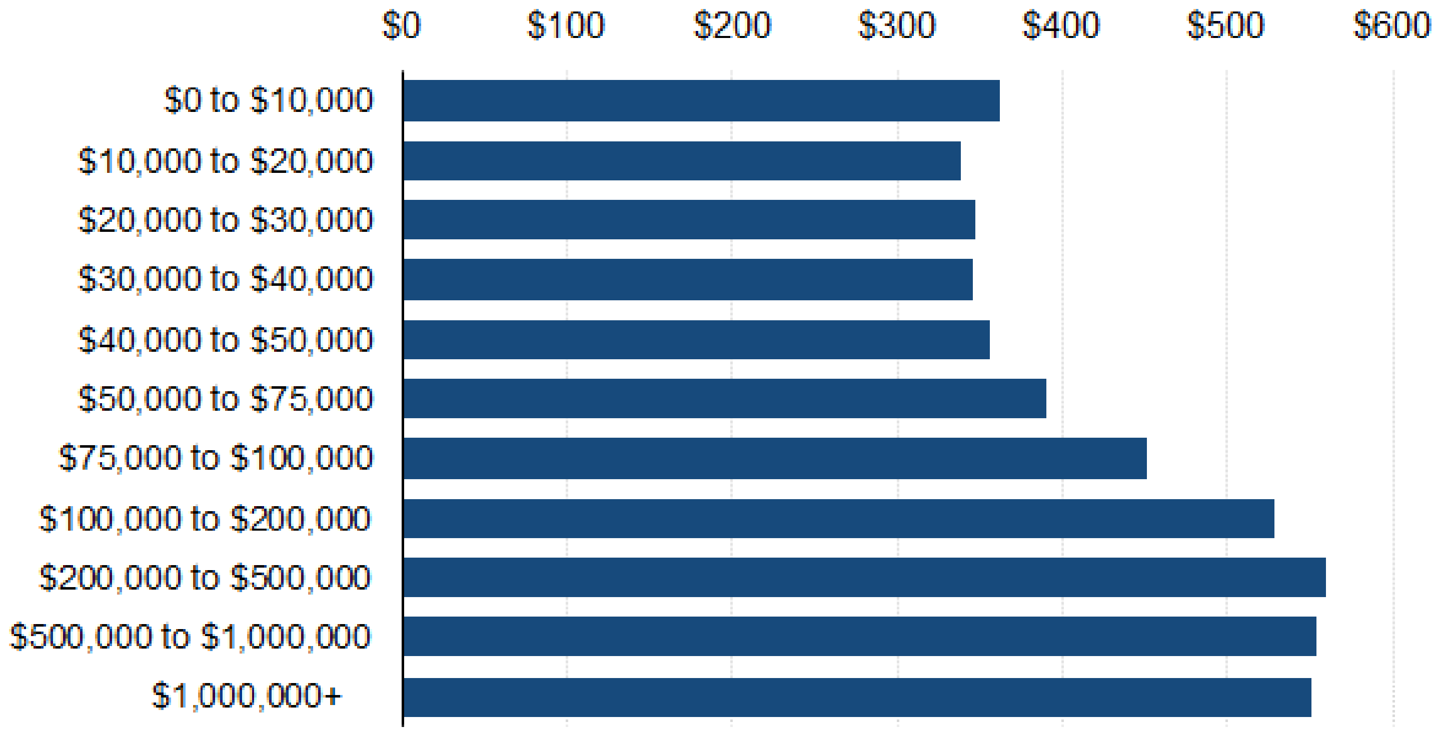
- Lowered top rate on income greater than $10,000 from 5% to 4%
- Eliminated an income tax bracket
- Rate reduction is phased-in over multiple years but we show effect of changes when fully implemented
- Average tax cut for households earning between $10,000 and $100,000 range from $20 to $900

One-time tax rebate

- One-time tax rebates are special government payments to a designated group of residents
  - Possible groups: All tax filers, all tax filers with income limits (e.g., no rebates for filers with AGI above $150,000), only EITC recipients, only filers with a tax liability (i.e., filer paid income tax in a specific year)
- California (twice), Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho (twice), Illinois, Indiana, Maine, Maryland, New Mexico, Oregon, Rhode Island, South Carolina, and Virginia passed a tax rebate in CY 2021 or 2022
  - Arkansas, Indiana (a second), Massachusetts may also soon pass one-time tax rebates
  - Some states send property tax rebates every year (e.g., PA and NJ) and sent larger rebates this year—we counted this as property tax relief and not a one-time tax rebate

Average One-Time Delaware Tax Cut (2022)

by adjusted gross income group



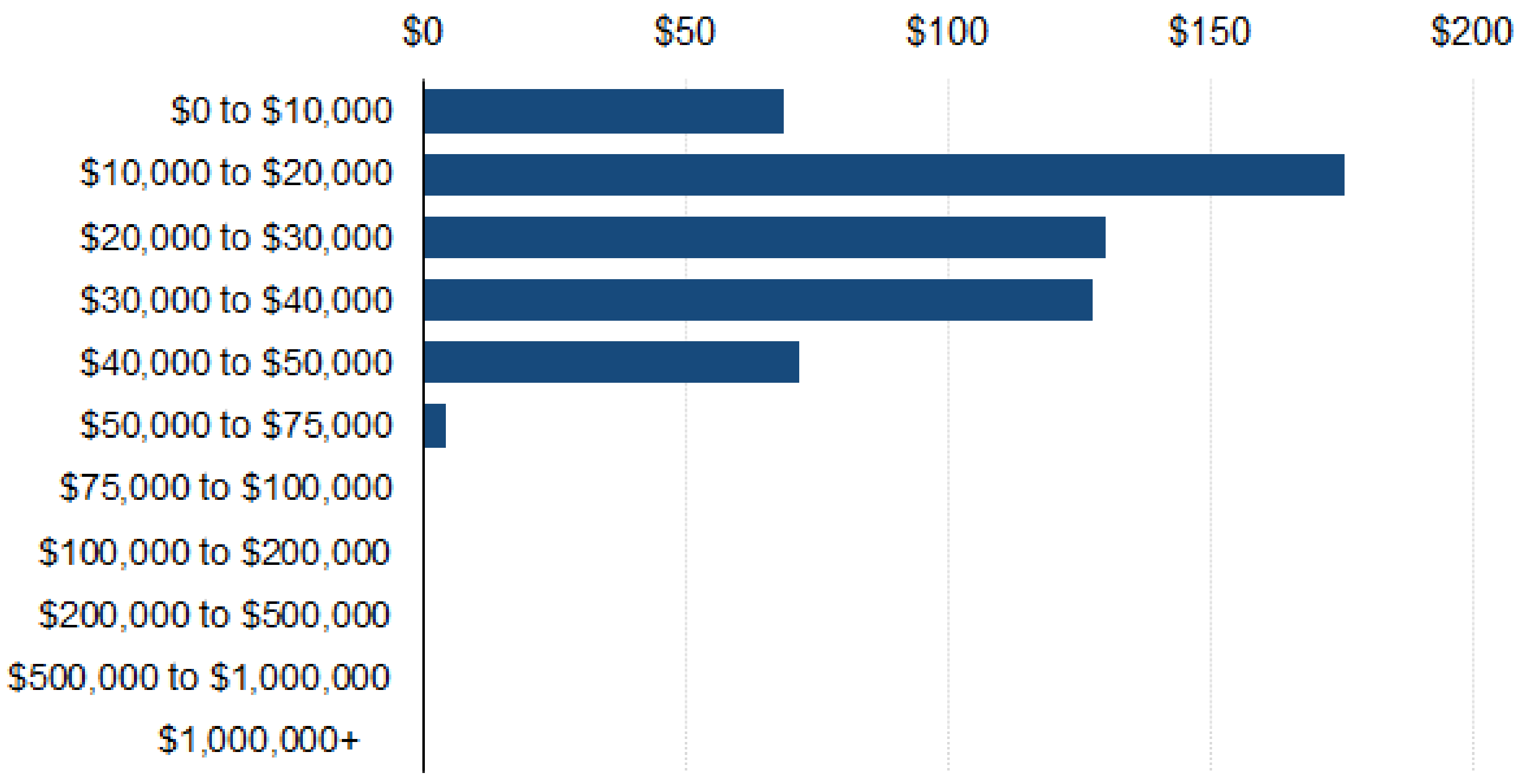
Delaware's rebate

- One-time tax rebate of $300 for single filers and $600 for married
- Available to all filers
- No income limits
- Average tax cut increases with income because households at those income levels are more likely to be married

- New Mexico's second rebate (HB 2) would have a similar distribution
- Its first (HB 163) would look similar but households above $75,000 did not benefit (so no blue bar)

Average One-Time Maryland Tax Cut (2021, only tax rebate)

By adjusted gross income group



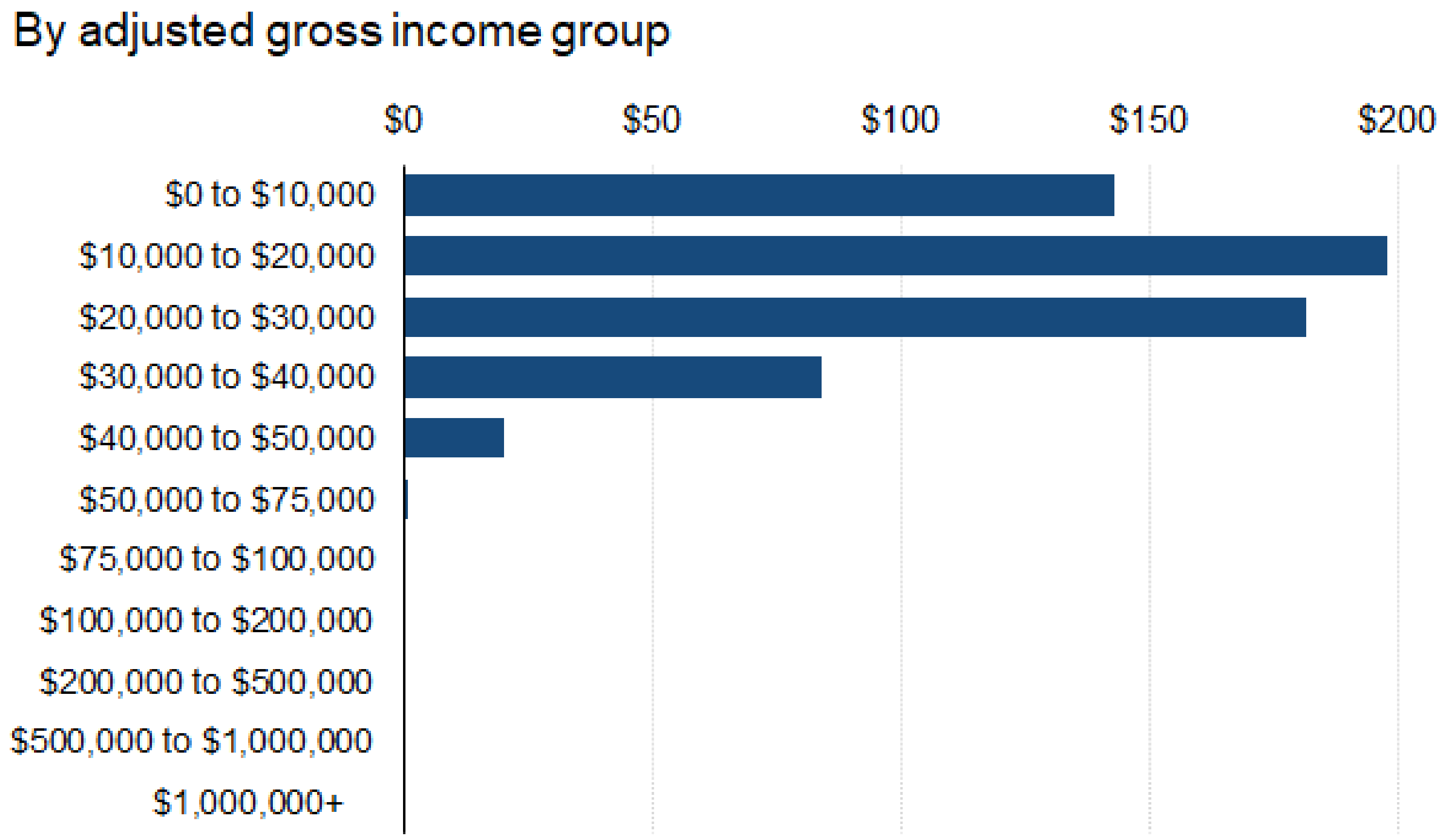
Maryland's rebate

- As part of a larger tax package, Maryland sent $300 to single filers and $500 to married and HoH filers, but only if filer received the EITC
- Average tax cuts vary because different income groups have more or fewer EITC-eligible households
- EITC rule is also why high-income households do not see a benefit
- In that sense, distribution is similar to how rebates with income limits based on AGI would work (i.e., no benefits for any filers at higher income levels)

Earned income tax credit

- In addition to creating an EITC, states can expand an existing EITC by …
  - **Increasing the match**. Most state EITCs are calculated as a percentage of the federal EITC, so a state can provide tax relief by increasing its match rate (e.g., New Mexico increased its match from 17% of the federal credit to 25%)
  - **Expanding support for "childless" workers**. A filer without a child on their return (i.e., may still be a parent) gets a smaller federal EITC and thus smaller state EITC. Some states help these filers by specifically expanding the match for them (e.g., Maryland increased its match for childless workers to 100% while it increased it to 50% for all others)
  - **Supporting undocumented workers.** Every person on the return must have a Social Security number to claim the federal EITC. But some states allow filers with Individual Taxpayer Identification Number (ITIN) to claim the state credit
- A refundable EITC helps low-income workers; a nonrefundable credit does not
- Colorado, Connecticut, Delaware, the District of Columbia, Hawaii, Illinois, Indiana, Maine, Maryland, Minnesota, Missouri, New Jersey, New Mexico, Oklahoma, Oregon, Utah, Vermont, Virginia, and Washington enacted or expanded an EITC in CY 2021 or 2022

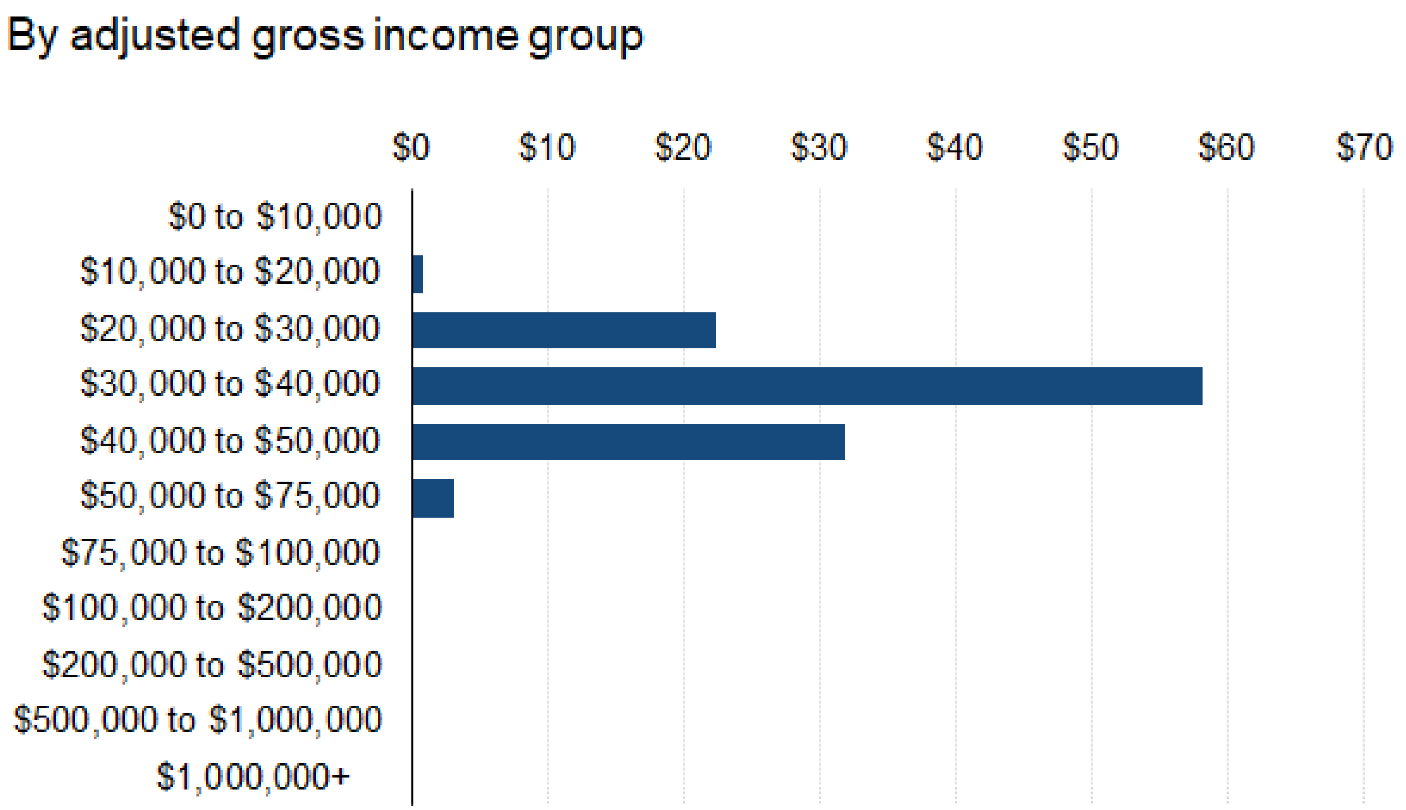
Average Annual New Mexico Tax Cut (2021)



New Mexico's tax cut

- Increased state's refundable EITC match from 17% to 25%
  - Happens over time but we modeled as if all at once
- Expanded Low-Income Comprehensive Tax Rebate
  - Works somewhat like a standard deduction

Average Annual Utah Tax Cut (2022, just EITC)



Utah's EITC

- As part of a larger tax package, Utah created a 15% EITC
- However, unlike New Mexico's EITC (and most state EITCs) Utah's credit is *nonrefundable*
- As a result, the average tax cuts are far smaller and many low-income households do not get a tax cut

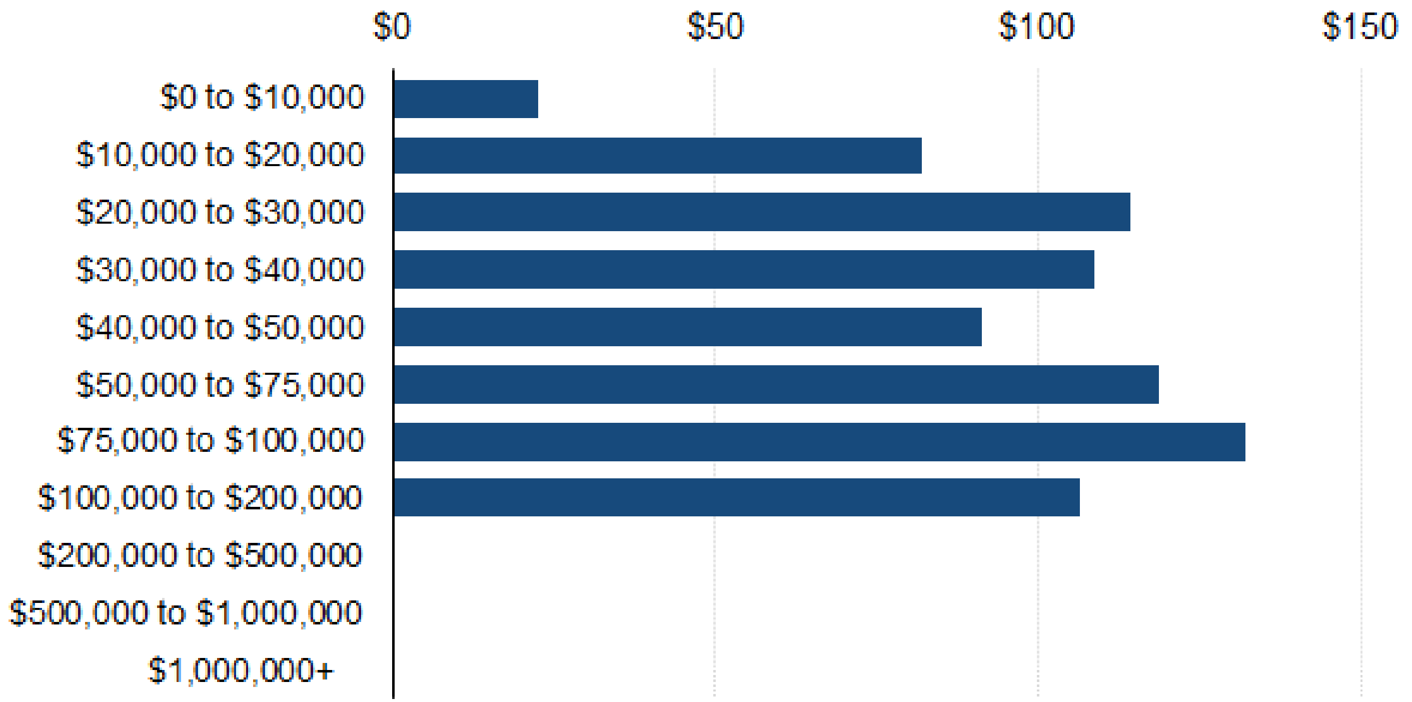
- *The main component of Utah's tax cut was a rate cut. We are not showing that in this chart so we can highlight how a nonrefundable EITC works*

Child tax credit

- Unlike state EITCs, a state CTC is *not* typically calculated as a share of the federal CTC, so state credit amounts and eligibility rules vary
- Four states created a CTC in CY 2021 and 2022
  - **Colorado**. Refundable credit is calculated as share of federal CTC (exception to rule). Only available for children younger than age six. Limited to filers with less than $75,000 (single) and $85,000 (married) in AGI
  - **New Jersey**. Refundable $500 credit. Only available for children younger than age six. Limited to filers with less than $80,000 in taxable income
  - **New Mexico**. Refundable credit of up to $175. Credit amount falls with AGI (e.g., $25 for filers with $350,000 or more). Available to all children who are dependents
  - **Vermont**. Refundable $1,000 credit. Only available for children younger than age six. Limited to filers with less than $125,000 in AGI
- New York was previously only state with refundable state CTC

Average Annual Vermont Tax Cut (2022, just CTC)

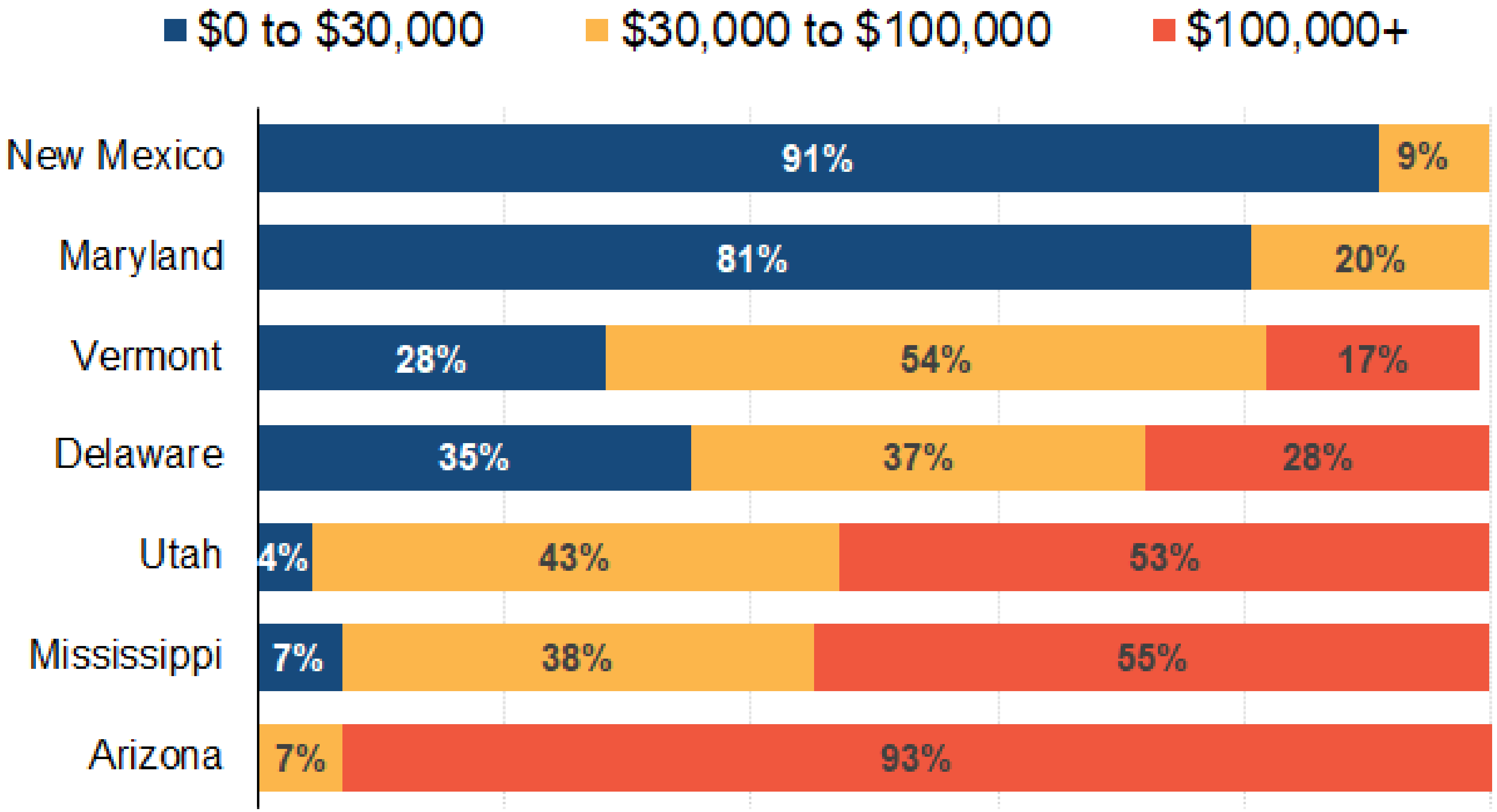
By adjusted gross income group



Vermont's CTC

- As part of a larger tax package, Vermont created a $1,000 CTC
  - The amount phases down as income increases
  - Filers earning more than $125,000 do not get the credit
  - Only available for children younger than age six
- Among households getting a tax cut, the average tax cut is closer to $1,000. But for all households the average is lower because only 2% to 12% of any income group gets the credit (i.e., has eligible children)

Comparison of benefits from each state's tax cuts



A refundable EITC or CTC was biggest part of tax cuts in New Mexico, Maryland, and Vermont

Delaware sent tax rebates to all filers

An income tax rate cut was the largest part of tax cut packages in Utah, Mississippi, and Arizona

Pros and cons of major state tax cuts

Income tax rate cuts

PROS

- Supporters argue (permanent) lower tax rates encourage business and job creation
  - While we have found no evidence of a connection between tax cuts and economic growth, taxes are one (of many) factors in business and personal location decisions

CONS

- Most of the benefit goes to households earning $100,000 or more, while most low-income households see little or no benefit
- Revenue cost is large and permanent so it will affect future budgets (possibly under very different economic conditions)
  - Arizona’s 2021 tax cut will cost roughly $1.6 billion annually (when fully phased-in)

One-time tax rebates

PROS

- Can benefit any type of tax filer—depending on eligibility rules
- One-time cost aligns with one-time surplus (i.e., it will not affect future budgets)

CONS

- While the money could help many (especially low-income) households make purchases the rebates also could exacerbate inflation problems
- Opportunity costs. What else could the funds been spent on?

EITC and CTC

PROS

- Target benefits at low- and middle-income households
  - But only if the credit is *refundable*
- Relatively low revenue cost
  - New Mexico's 2021 tax cut (EITC and LICTR) will cost roughly $100 million annually

CONS

- Both EITC and CTC have eligibility restrictions that limit who gets benefits
  - For example, in 2021, average tax cut *for those who got a tax cut* was higher in Maryland ($800) than New Mexico ($170), but a far higher percentage of households in New Mexico (57%) than Maryland (13%) got a tax cut
    - *This is because all of Maryland's tax relief was delivered via the EITC, while New Mexico increased its EITC and increased credit available to nearly all low-income households*

Other state tax cuts

General sales tax cut

- New Mexico was the only state to lower its general sales tax rate in CY 2021 and 2022
  - New Mexico technically has a “gross receipts tax” but it functions more like a general sales tax
- Kansas, Illinois, and Virginia eliminated or suspended state sales taxes on grocery food
- Sales taxes are regressive (i.e., larger burden on lower-income households) so a rate cut benefits low-income households (as share of income; high-income gets more total dollars)
- Sales tax rate cuts and grocery food exemptions are permanent and will affect future budgets

Gas tax suspension

- Connecticut, Florida, Georgia, Illinois, Maryland, and New York suspended their gas tax
- Hard to prove consumers (instead of sellers) benefit from suspension, and even if consumers got all of the tax savings, the amount is very small (state gas taxes are cents per gallon)
- Gas tax suspensions have large revenue costs that can negatively affect transportation spending—but they are only temporary

What comes next?

Uncertainty remains and reigns

- Inflation, rising interest rates, an ongoing pandemic, and the war in Ukraine could all slow economic growth and put pressure on state budgets … or economic growth and strong state tax collections could continue
  - An April analysis of state revenue forecasts showed total state tax revenue (nationally) was expected to increase 0.1% in fiscal year 2023
- More than two-thirds of state American Rescue Plan funds have been spent or allocated
  - All pandemic-era federal tax relief and stimulus programs have expired
- All of the individual income tax provisions (except inflation indexing) in the Tax Cuts & Jobs Act (2017) are set to expire at the end of CY 2025
  - The corporate income tax changes in the Inflation Reduction Act (2022) could also affect state tax collections
- We have no idea what political party will control Congress or the White House after the 2022 and 2024 elections

What does that mean for states?

- The fiscal situation *could* be worse for *some* states next year
  - That depends not only on national and global economic trends but also on the state, its economy, and its tax system
- Just as some states cut taxes in good times, states would have to make tough decisions on tax increases or spending cuts if revenue collections slow or fall
- And just as there are numerous ways to cut taxes, there are also numerous ways to increase taxes—with different winners and losers
- In general, building up reserves and having fiscal flexibility, while simultaneously meeting the needs of the state and its voters, is the best policymakers can do in preparation for uncertain economic conditions

Thank you

Tax Policy Center
https://www.taxpolicycenter.org/

Urban's State and Local Finance Initiative
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